



KINGDOM OF LESOTHO

SIXTH REVIEW UNDER THE THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

September 2013

In the context of the Sixth Review Under the Three-Year Arrangement Under the Extended Credit Facility, the following documents have been released and are included in this package:

- **Staff Report** for the Sixth Review Under the Three-Year Arrangement Under the Extended Credit Facility, prepared by a staff team of the IMF, following discussions that ended on June 24, 2013 with the officials of Lesotho on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 21, 2013. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Debt Sustainability Analysis** prepared by the staff of the International Monetary Fund and the World Bank.
- **Press Release** dated September 9, 2013.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Lesotho*
Memorandum of Economic and Financial Policies by the authorities of Lesotho*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: <http://www.imf.org>



KINGDOM OF LESOTHO

SIXTH REVIEW UNDER THE THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

August 21, 2013

KEY ISSUES

Background. Lesotho has weathered a series of shocks, including the fall in Southern African Customs Union (SACU) revenues in 2010–11, floods in early 2011, high international commodity prices, and a drought in 2012. Policies supported by the Extended Credit Facility (ECF) arrangement have helped to improve international reserves. The authorities' policy priorities include (i) rebuilding international reserves to five months of imports coverage over the medium term; (ii) maintaining fiscal consolidation to support the accumulation of reserves and ensure fiscal and external sustainability; and (iii) implementing structural reforms to facilitate private sector-led growth. The authorities are committed to continuing fiscal consolidation in 2013/14, while safeguarding social spending and growth-promoting capital expenditure. Structural reforms aim at improving efficiency of the public sector and promoting private sector development.

Program performance. The Executive Board approved a three-year ECF arrangement in the amount of SDR 41.88 million (120 percent of quota) in June 2010, after a sharp fall in SACU revenues. To cushion the impact of the 2010–11 flood damage and high international commodity prices, the Board approved an augmentation of access of 25 percent of quota in April 2012, bringing total access to SDR 50.605 (145 percent of quota). The fifth review under the ECF arrangement was concluded on May 9, 2013. The program is on track, with all end-March 2013 quantitative performance criteria and indicative targets met. One structural benchmark (SB)—the establishment of the cash management unit—was implemented, though two other SBs—the reconciliation of all treasury accounts and the submission of the amendments of the Loans and Guarantees Act to parliament—were not met. The authorities are interested in a successor three-year arrangement, which would expedite achieving the medium-term reserve target; help address structural weaknesses and catalyze support from its international partners. Following a planned national workshop to shape the key reforms agenda, negotiations on a new arrangement could begin at the time of the next Article IV consultation in early 2014.

Staff views: Staff recommends the completion of the sixth review under the ECF arrangement and the disbursement of SDR5.68 million. The authorities gave consent to the publication of the staff report and the Letter of Intent with attachments.

Approved By
**Anne-Marie Gulde-
 Wolf, AFR, and Chris
 Lane, SPR**

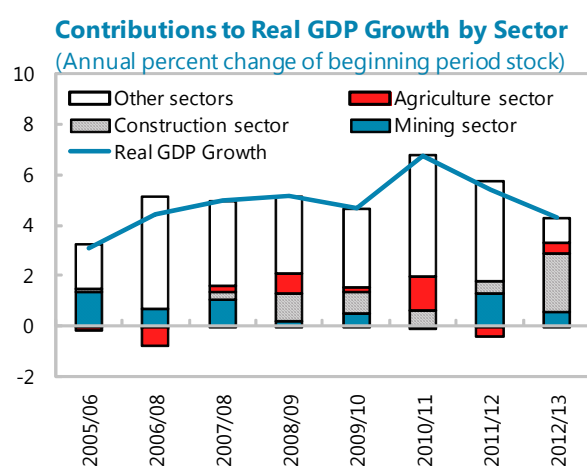
The mission visited Maseru on June 11–24, 2013. The mission met with the Finance Minister Ketso; Central Bank of Lesotho Governor Matlanyane; other senior government officials; representatives of the donor community; and the private sector. The staff team comprising J. Honda (head), I. Masha, M. Morgan, and N. Koliadina (all AFR) was assisted by M. Tharkur, resident representative.

CONTENTS

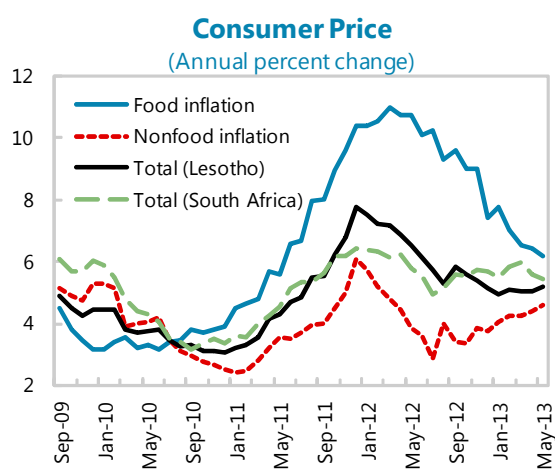
RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK	3
PROGRAM PERFORMANCE	5
POLICY DISCUSSIONS	6
A. Safeguarding Macroeconomic Stability	6
B. Supporting Private Sector Development and Sustainable Growth	8
SAFEGUARDS ASSESSMENTS AND A SUCCESSOR PROGRAM	9
STAFF APPRAISAL	11
BOXES	
1. Prospects for the Second Phase of the Lesotho Highlands Water Project	4
2. Status of Remaining Structural Benchmarks	6
3. Strengthening Debt Management	8
4. Achievements Under the Current ECF Arrangement (2010–13)	10
TABLES	
1. Selected Economic Indicators, 2009/10–17/18	13
2. Fiscal Operations of the Central Government, 2009/10–17/18	14
3. Fiscal Operations of the Central Government, 2009/10–17/18	15
4. Monetary Accounts, 2011–14	16
5. Balance of Payments, 2009/10–17/18	17
6. Commercial Bank Performance Ratios, 2005–13	18
7. Indicators of Capacity to Repay the IMF	19
8. Schedule of ECF Disbursements and Reviews, 2011–13	20
APPENDIX	
I. Letter of Intent	21
ATTACHMENT	
I. Memorandum of Economic and Financial Policies	23

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

1. Lesotho maintained robust economic growth, with moderate inflation. Despite adverse weather conditions, real GDP growth for 2012/13 is estimated at 4½ percent, driven by strong construction activities (with large investments in infrastructure, houses, and mines) and, to a lesser degree, by increased mining production. Inflation, at 4½ percent in June 2013, has further subsided, reflecting moderation in international commodity prices. The loti, pegged to South Africa's rand, has been depreciating against the U.S. dollar (by 18 percent during the 12 months through June 2013). Its pass-through effect on domestic prices, however, has been limited, largely owing to a high concentration of imports from South Africa.¹



Sources: Data from the authorities; and IMF staff estimates.



Sources: Data from the authorities; and IMF staff estimates.

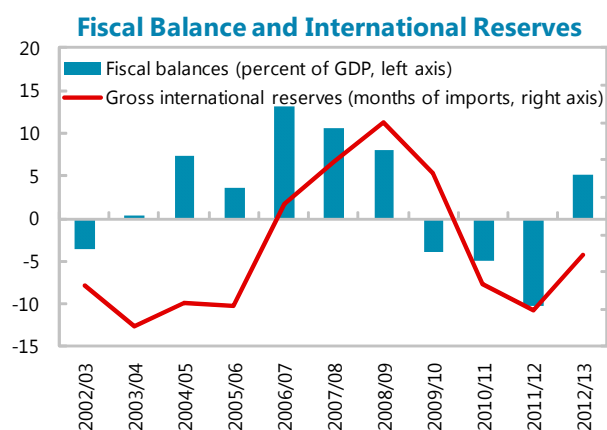
2. In 2012/13, fiscal balances improved with the authorities' adjustment efforts and the recovery of revenues from the Southern African Customs Union (SACU). For the first time since 2008/09, the government recorded a fiscal surplus estimated at 5¼ percent of GDP, largely owing to a recovery in SACU revenues and the authorities' fiscal consolidation efforts, including through lower than budgeted capital spending. Drought-related spending did not affect budget execution, because it was financed through the reallocation of funds within the approved budget and foreign assistance. Domestic revenues slightly fell short of projection, partly because some mining companies claimed tax credit on their investments and refrained from dividend payment.

3. Commercial banks' lending continued to expand, while non-performing loans (NPLs) remained low. Private sector credit rose by 39 percent in 12 months through May 2013, albeit from a low base, reflecting strong demand for consumer and mortgage loans and lending to the mining sector. The banks have been expanding lending to broader segments of the population following the enactment of the Land Act, which enabled the use of land as collateral. Credit expansion has

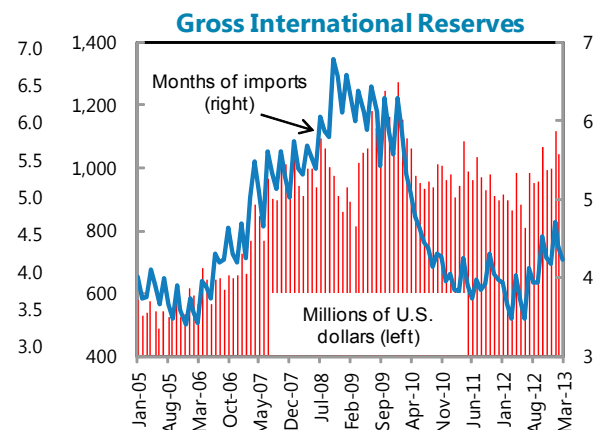
¹ Historically, there has been little correlation between the consumer prices and the U.S. dollar-loti exchange rate.

been financed largely by banks drawing on their assets held with their parent banks in South Africa. Banking sector indicators remain benign, with the NPLs to asset ratio staying below three percent and provisions for NPLs exceeding 100 percent, for the last three years.

4. External balances improved and international reserves rose, as fiscal consolidation continued. The current account deficit narrowed to 10 $\frac{1}{3}$ percent of GDP in 2012/13, against 24 $\frac{1}{4}$ percent of GDP a year ago, supported by fiscal consolidation, offsetting the adverse impact of low international diamond prices. International reserves rose to 4 $\frac{1}{4}$ months of imports at end-March 2013, compared with 3 $\frac{1}{2}$ months of imports a year ago.



Source: Data from the authorities; and IMF staff estimates.



Sources: Data from the authorities; and IMF staff estimates.

5. Economic growth is expected to stay robust in the coming years. It is projected to exceed 4 percent, supported by a recovery in agricultural production, enhanced construction, and mining sector expansion. Over the medium-term, the development of electricity infrastructure and the implementation of the second phase of the Lesotho Highlands Water Project (LHWP II) scheduled for 2014–2022, would further boost construction and economic activity (Box 1).

Box 1. Lesotho: Prospects for the Second Phase of the Lesotho Highlands Water Project

The Lesotho Highlands Water Project (LHWP) is a binational project which involves construction of a system of dams and tunnels to transfer water from Lesotho to South Africa, and roads and hydroelectricity generation for use in Lesotho. Following the signing of a treaty in 1986 between the two countries, the project has been implemented in phases, with the first phase completed in 2004.

The second phase of the LHWP is expected to boost economic growth through investment activity, broaden the export base (water), and support private sector development. The total cost of the project is estimated at M16.8 billion, or 81 percent of GDP, with a water transfer component (M9.2 billion) funded by South Africa and a hydro-power station (M7.6 billion) funded by the government of Lesotho (for which external financing will be sought). The implementation of the project is expected to take 7–8 years, with the construction of the water transfer component expected to start in 2014.

Following an agreement in May 2013 and subsequent ratification by the Government of Lesotho in June, the appointment of a project management unit is expected shortly and construction of the LHWP II will begin under the direction of the Lesotho Highlands Water Authority.

6. Lesotho's growth prospects are subject, however, to significant downside risks.

Specifically, the risks for the South African economy may arise from domestic labor market challenges and weak European demand.² The spillover effects from South Africa could be channeled through weaker SACU revenues, foreign direct investment, trade and financial flows.³ With rapid local private sector credit growth, albeit from a low base, excessive risk-taking by banks could be another source of downside risks. Furthermore, the slow recovery of international diamond prices could undermine the expansion of the mining industry in Lesotho, adversely affecting economic growth and exports. In the medium term, in the absence of a renewal of the African Growth and Opportunity Act (AGOA) now expiring in 2015, the large textile industry is likely to contract, which could worsen unemployment and growth prospects. There is also upside risk to the growth prospects, depending on higher than expected returns from the implementation of the National Strategic Development Plan (NSDP), including more private sector follow-up investment.

PROGRAM PERFORMANCE

7. The Extended Credit Facility (ECF)-supported program is broadly on track. The ECF arrangement was extended to September 30, 2013, together with related rephasing of the disbursement, to ensure sufficient time to complete the sixth review. All end-March 2013 quantitative performance criteria (PCs) and indicative targets were met (MEFP, Table 1). Net domestic financing of the government and net international reserves were met with comfortable margins, reflecting the authorities' stepped-up adjustment efforts. The central government social expenditure (indicative target) overperformed in January–March 2013, largely offsetting the minor slippage in July–September 2012.

8. Progress in implementing the structural benchmarks was mixed. Of the three structural benchmarks (SBs), one—the establishment of the Cash Management Unit (CMU) in the treasury—has been implemented, while the other two SBs—the reconciliation of all treasury accounts and the submission of the Public Debt Management Bill to Parliament—were not met (Box 2).⁴ Following internal consultations, the Public Debt Management bill has been sent to the attorney general and is expected to be submitted to parliament by end-September. The reconciliation of treasury accounts has been delayed, largely owing to insufficient collaboration between the treasury and budgetary agencies. To address the problem, the Ministry of Finance issued a circular in June 2013 to enforce reconciliation reporting by all such agencies.

² South Africa faces serious challenges of income inequality and high unemployment.

³ Lesotho's banking system is dominated by South African banks.

⁴ The Public Debt Management Law incorporates the necessary legislative changes initially envisaged in the form of the amendments to the Loan and Guarantee Act which submission to Parliament was set as a structural benchmark.

Box 2. Lesotho: Status of Remaining Structural Benchmarks

The authorities have been taking credible steps toward the implementation of the remaining two SBs.

- The Public Debt Management bill has been prepared, with technical assistance from the IMF, and will be submitted to parliament by end-September. The draft bill has been sent to the Attorney General's Office for certification before cabinet policy clearance and submission to parliament.
- Progress has been made in the reconciliation of all treasury accounts on a monthly basis. Currently, government expenditure accounts held at the Central Bank of Lesotho (CBL) are being reconciled on a daily basis. However, the reconciliation of the commercial bank accounts and government revenue through the main revenue account has been delayed, largely owing to challenges with the Integrated Financial Management Information System (IFMIS) and the inability of budgetary agencies to provide information for reconciliation. The government has addressed the issue by suspending the accounts of the agencies not compliant with the reconciliation requirements, which helped collecting information needed for monthly reconciliation. The treasury regulations, facilitating the implementation of the Public Financial Management Act, have also been finalized.

POLICY DISCUSSIONS

9. The discussions focused on policies aiming at maintaining macroeconomic stability and achieving sustainable and inclusive growth. Given the authorities' commitment to maintain the exchange rate peg to the South Africa's rand (which helped to anchor price stability while facilitating capital and financial transactions with South Africa), it is essential to secure a comfortable reserve cushion to withstand exogenous shocks, frequently affecting Lesotho. While maintaining fiscal and external sustainability, the National Strategic Development Plan (NSDP) aims at achieving high, shared and employment creating economic growth. Specifically the implementation of structural reforms, including developing a strong financial system; effective and efficient public financial management (PFM); and a business-friendly investment climate would support macroeconomic stability and sustainable growth. The key policy challenges remain achieving a comfortable international reserve cushion, ensuring fiscal and external sustainability, and facilitating the country's growth potential to ensure poverty reduction.

A. Safeguarding Macroeconomic Stability

10. The authorities remain committed to bringing reserve coverage to five months of imports over the medium term. The authorities reiterated their goal of achieving the reserve coverage of five months of imports by 2016/17 through continued fiscal consolidation and reforms promoting economic diversification and attracting foreign direct investment. This level of international reserve cushion is deemed appropriate, in light of Lesotho's vulnerability to exogenous shocks (e.g., weather-related shocks, volatile SACU revenues).⁵

⁵ Looking back, Lesotho had successfully accumulated reserves covering 5–7 months of imports in 2007–09, providing an effective cushion against the drop in SACU revenues in 2010–11.

11. Continued fiscal consolidation requires revenue mobilization and the rationalization of spending. The non-SACU deficit is projected to narrow to 19¼ percent of GDP in 2013/14, primarily through improved domestic tax collection and the containment of recurrent spending.⁶ The authorities remain committed to (i) limiting the filling of the vacant posts in the civil service; (ii) reducing non-priority outlays through stricter expenditure control; (iii) limiting contingency spending to emergencies; and (iv) implementing revenue administration measures following the completion of the restructuring of the Lesotho Revenue Authority (LRA). Over the medium term the government will conduct a comprehensive review of the payroll with the aim to rationalize spending on wages and salaries.⁷ Savings in recurrent spending, along with a projected increase in tax revenue, would help finance priority public investments. These measures would bring the reserve coverage to 4⅔ months by the end of 2013/14.

Fiscal Performance 2009/10-2017/18^{1 2}												
	2009/10		2010/11	2011/12	2012/13		2013/14		2014/15	2015/16	2016/17	2017/18
	Act.	Prel.	Proj.	Proj.	EBS/13/46 ³	Proj.	EBS/13/46 ³	Proj.	Proj.	Proj.	Proj.	Proj.
(Percent of GDP)												
Revenue and grants	62.4	51.3	50.9		65.5	64.1	61.2	61.5	52.9	49.8	49.3	48.9
Tax revenue	21.3	21.0	22.7		23.5	22.4	24.5	24.5	24.4	24.5	24.7	24.6
Non-tax revenue	5.2	7.4	6.0		4.9	4.5	4.5*	4.5	5.0	4.8	5.0*	5.0
SACU	32.9	15.8	14.6		28.9	28.9	25.4	25.3	21.2	18.4	17.4	17.1
Core SACU	15.0	15.0	15.0		15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
Noncore SACU	17.9	0.8	-0.4		13.9	13.9	10.4	10.3	6.2	3.4	2.4	2.1
Grants	3.0	7.2	7.6		8.2	8.3	6.8	7.2	2.2	2.0	2.2	2.2
Budget support	0.0	2.2	1.5..		0.9	1.0	1.3	1.4	0.6	0.6	0.5	0.5
Project grants	3.0	5.0	6.1..		7.3	7.3	5.6	5.8	1.6	1.5	1.7	1.7
Total expenditure	66.3	56.2	61.2		60.7	58.9	59.2	59.6	50.8	46.0	45.5	45.1
Recurrent	47.7	38.3	39.6		39.0	38.9	39.0	38.9	36.4	34.0	32.6	31.8
Capital expenditure	18.6	18.0	21.5		21.7	20.0	20.2	20.6	14.4	11.9	12.9	13.3
of which: domestically funded	13.8	11.3	13.4		10.4	9.6	10.6	10.6	9.7	9.4	9.1	9.5
Overall balance, incl. grants	-3.9	-4.9	-10.3		4.8	5.2	2.0	1.9	2.1	3.8	3.8	3.8
Overall balance, excl. grants	-6.9	-12.1	-17.9		-3.5	-3.0	-4.8	-5.3	-0.1	1.8	1.6	1.7
Core-SACU fiscal balance (excl. foreign-financed capital projects) ⁴	-20.0	-4.9	-7.8		-5.1	-5.6	-4.3	-4.2	-1.0	1.5	3.5	3.8
Non-SACU balance (incl. foreign-financed capital projects)	-36.8	-20.7	-24.8		-24.1	-23.7	-23.4	-23.4	-19.1	-14.6	-13.6	-13.3
Non-SACU balance (excl. foreign-financed capital projects)	-35.0	-19.9	-22.8		-20.1	-20.6	-19.3	-19.2	-16.0	-13.5	-11.5	-11.2
Financing	-1.2	1.6	7.7		-4.8	-8.2	-2.0	-1.9	-2.1	-3.8	-3.8	-3.8
Domestic (net)	-1.4	2.1	6.8		-7.6	-10.1	-4.8	-4.9	-4.3	-4.0	-5.2	-5.3
Foreign (net)	0.1	-0.4	0.9		2.8	1.9	2.8*	3.0	2.1	0.2	1.4*	1.5
Statistical discrepancy ⁵	5.1	3.3	2.6		0.0	-3.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Ministry of Finance and IMF staff estimates.
1 The fiscal year runs from April 1- March 31.
2 Based on the GFSM 1986 format.
3 Values as in the fifth ECF review.
4 Core SACU revenue is set at 15 percent of GDP, close to the lowest historical level, far below the historical average (26 percent of GDP for the last 20 years).
5 The fiscal discrepancy partly reflects the difficulty associated with IFMS with some revenue underrecorded in the system.

⁶ The authorities have been working on the recovery of unpaid taxes, expanding taxpayers' registration, and strengthening tax compliance. The government plans to undertake a comprehensive review of income taxes and the VAT, and to review the mining taxation regime, based on technical assistance from the IMF.

⁷ Currently the authorities are conducting an internal payroll audit in the Ministry of Health that could serve as a home-grown model for a series of pilots in other ministries. Depending on the success of these pilots, the government will decide whether to extend the audit exercise for the whole public sector. The World Bank has encouraged the authorities to compile data on number, grade, pay, and service details of all civil servants to have a more accurate view of the size of the existing civil service. The World Bank stands ready to provide advice and analytical assistance to the authorities to determine the appropriate staff complement for efficient and effective delivery of government development programs.

12. The fiscal stance is compatible with maintaining a moderate risk of debt distress over the medium term, while legal and institutional frameworks for debt management are being strengthened. The public debt to GDP ratio is projected to stay below 38 percent of GDP in coming years, before reaching 39 percent in 2021 with the prospective financing for the LHWP II. The risk of debt distress remains moderate (Appendix), even if borrowing associated with the LHWP II is not on concessional terms. Furthermore, to help ensure debt sustainability, the authorities are strengthening the legal and institutional frameworks for debt management (Box 3) and also continue to seek concessional external financing.

Box 3. Lesotho: Strengthening Debt Management

Based on the recent update of the DSA, Lesotho remains at moderate risk of debt distress. Debt ratios are projected to remain manageable over the medium-term as SACU revenues recover and the fiscal position improves. Lesotho's public debt stood at 38 percent of GDP at end-2012/13, with most of it owed to external multilateral creditors. Public domestic debt held by residents is low, and presently comprises treasury bills and treasury bonds.

Though debt indicators are relatively benign, there is significant room to strengthen institutional and legal frameworks. The authorities, therefore, are stepping up their efforts to strengthen debt management, addressing a range of institutional and operational challenges. Key initiatives are:

- **Strengthening the legal framework for debt management.** With technical assistance provided by the IMF, a new Public Debt Management bill has been prepared and is expected to be submitted to parliament by end-September 2013. This bill will consolidate and address weaknesses in the existing legal framework for public debt management, and will replace the Loans and Guarantee Act and other existing relevant laws. The bill addresses, among other issues; (i) the objectives of public debt management; (ii) the purposes of borrowing; (iii) a requirement for the Ministry of Finance (MOF) to design a medium-term debt management strategy; (iv) the formal establishment of debt management committees; and (v) the requirement of external auditing of public debt management activities. The bill also provides a basis for a principal-agent agreement between MoF and CBL to regulate the role of the CBL as the fiscal agent in the issuance of domestic government securities.
- **Strengthening the institutional framework for debt management.** The Debt Management Committee has been fully operational since late 2012. The procedures for the evaluation and approval of new foreign lending have been tightened, with all negotiated loans to be reviewed by this committee before seeking the cabinet's consent. The capacity of staff of the Ministry's Public Debt and Aid Management Department and its Legal Department in relevant areas is being continuously strengthened. Under the new Public Debt Management Act, the current Public Debt Management Division at the MOF will be upgraded to a department, with its director reporting directly to the minister.
- **Preparing a Medium-Term Debt Management Strategy (MTDS).** Based on the Debt Management Performance Assessment (DEMPA), undertaken by the World Bank in late 2012, the authorities have been working on a broader reform plan and an MTDS. With the Bank's further technical assistance on designing an MTDS, Lesotho's first formal MTDS is expected to be formulated by end-2013/14.

B. Supporting Private Sector Development and Sustainable Growth

13. The authorities have made progress in improving the business climate, to promote private sector-led growth. To facilitate the implementation of the Industrial Licensing Act, associated regulations are being prepared and will be finalized by end-September 2013. Progress has been made on developing the national identification card system and establishing the credit rating system. The issuance of national identification cards—critical for the establishment of the

credit rating system (to foster bank lending to the private sector)—was launched in early July. Furthermore, the authorities plan to collaborate with the World Bank to improve access to land and finance, facilitate cross-border trade, and complete the national identification card project.

14. To further reduce poverty and make growth more sustained and broad based, the authorities are stepping up efforts to implement the National Strategic Development Plan (NSDP). To effectively implement the NSDP, the authorities have recently finalized the Public Sector Investment Programme (PSIP), the Implementation Plan, and the Monitoring and Evaluation Framework.⁸ Subsequently, they initiated a dialogue with international partners to mobilize resources to assist the implementation of the NSDP.

15. The Central Bank of Lesotho (CBL) has made progress in improving the legal and regulatory frameworks, to promote financial sector deepening with proper supervisory oversight. The CBL has prepared regulations for banks and nonbank financial institutions to facilitate the implementation of the Financial Institutions Act of 2012, with technical assistance from the IMF. In light of the recent rapid increase in private sector credit, the CBL is committed to closely monitoring the quality of bank loans through risk-based supervision and further strengthening supervision by reviewing the adequacy of current loan classification practices, provisioning rules, and collateral valuation practices. To facilitate financial intermediation and promote private sector development and inclusive growth, the CBL has been working on the Financial Sector Strategic Development Plan (FSSDP), with assistance from the IMF and the World Bank.

SAFEGUARDS ASSESSMENTS AND A SUCCESSOR PROGRAM

16. An update safeguards assessment was completed in November 2012 in connection with the augmentation of the ECF arrangement. The update confirmed that the CBL has taken steps to improve its safeguards framework since the 2010 assessment, although certain risks remain. The monetary data reporting process has been strengthened with IMF technical assistance. Audit oversight and internal audit remain areas where improvements are needed to strengthen overall governance and accountability. Deloitte (South Africa), appointed as the CBL's external auditor in 2010, completed the 2012 audit by end-March 2013 and issued an unqualified audit opinion. The CBL subsequently published the 2012 financial statement and related audit opinion on the bank's external website.

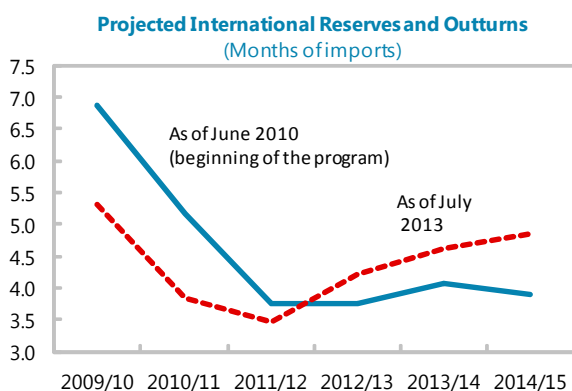
17. Continued program relations with the IMF could help Lesotho to maintain macroeconomic stability and facilitate structural reforms. With the successful outcome of the current ECF-supported program, the authorities expressed interest in maintaining program relations with the IMF (Box 4). The successor three-year IMF arrangement would support continued macroeconomic stability and sustainable growth, helping to achieve Lesotho's medium-term reserve target of five

⁸ The PSIP provides a five-year program of ongoing and prospective new investment projects, while the cost estimates have yet to be finalized.

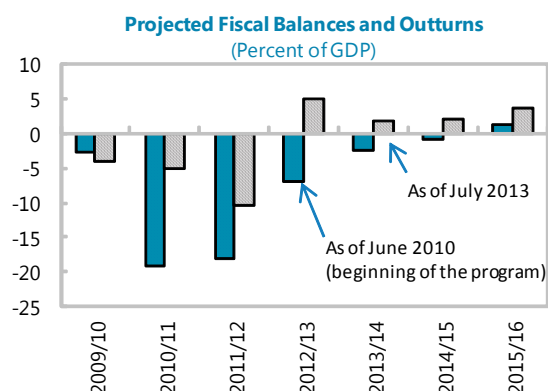
months of import coverage sooner. The program would also support macro-relevant structural reforms, with assistance from Lesotho's international partners. Strengthening public financial management remains a structural priority, and the IMF would continue supporting government's reform efforts in this area by providing technical assistance. Promoting inclusive growth and increasing private sector employment are also important macro-critical agenda items. To facilitate broad consultations and the ownership of the reform agenda, the authorities plan to hold a national economic workshop later this year.

Box 4. Lesotho: Achievements Under the Current ECF Arrangement (2010–13)

Lesotho's performance under the ECF-supported program has been satisfactory. Throughout the program, all but one quantitative performance criterion (PC) have been met, with one PC missed by a small margin. Out of 19 structural benchmarks (SB), 7 were implemented, as programmed, and 10 with delays; two SBs remain outstanding.



Sources: EBS/10/88; and IMF staff estimates.



Sources: EBS/10/88; and IMF staff estimates.

In the face of exogenous shocks, the program helped restore fiscal and external sustainability, while accommodating relatively robust growth. The recovery of international reserves, backed by stronger fiscal consolidation, outpaced that envisaged under the original program projections. International reserves at end-March 2013 reached 4¼ months of imports, compared with the original projection of 3¾ months (projected as of June 2010).

Fiscal adjustment—achieved primarily through the cuts of nonpriority spending and revenue mobilization—turned a deficit into a surplus. As a result of front-loaded fiscal adjustment, the non-SACU deficit (excluding foreign-financed capital projects) declined from 35 percent of GDP to 20 percent of GDP in the first year of the program). With subsequent adjustment efforts (including revenue administration reforms), some priority spending was accommodated in subsequent years.

Progress in structural reforms has been mixed. Financial sector regulation has been strengthened and the business climate has been gradually improving, with progress made in enhancing the legal framework (e.g., the Financial Institutions Act, the Insurance Act, and the Industrial Licensing Bill). The implementation of the public financial management (PFM) measures, however, has often been delayed, in part, because of weak cooperation between government agencies, with two SBs still outstanding. Further progress could be achieved through better coordination within the government and continued capacity building, with the support of Lesotho's international partners.

STAFF APPRAISAL

18. Lesotho's macroeconomic policies have served well to ensure fiscal and external sustainability while securing robust growth. Lesotho successfully maintained robust economic growth in recent years and strengthened its international reserve buffer, notwithstanding unfavorable weather and external economic conditions. Looking forward, in light of high downside risks and vulnerability to exogenous shocks, it is important to maintain fiscal and external sustainability while promoting broad-based, inclusive growth.

19. To maintain fiscal and external sustainability, staff welcomes the authorities' commitment to continued fiscal consolidation in 2013/14 and encourages them to continue prudent fiscal policies over the medium-term. It is important to contain recurrent spending (specifically public sector wages and goods and services) and further improve revenue administration following the completion of the restructuring of the LRA. This policy stance will help achieve the medium-term target of international reserves (equivalent to reserve coverage of five months of imports) by 2016/17.

20. To aid the implementation of prudent fiscal policies, it is important to make further progress in PFM reforms and civil service reforms. The establishment of the CMU and progress in monthly reconciliation of all the Treasury accounts will improve expenditure control and the monitoring of revenues. The implementation of these initiatives sets the stage for implementing a comprehensive PFM action plan aimed at developing sound public financial management. In addition, staff welcomes the authorities' reform intention to review the civil service to determine the optimal size of the civil service and restructuring needs to improve efficiency of the public sector. Such efforts would help to create fiscal space to implement the NSDP and finance priority infrastructure projects.

21. The CBL should continue to strengthen supervisory oversight of the financial sector and promote the sector's development. The recent rapid increase in private sector credit from a low base is welcome, but careful supervisory oversight is required to avoid any undue risks in the sector. Specifically, it is essential to review the adequacy of current loan classification practices, provisioning rules, and collateral valuation practices. To deepen the financial market in Lesotho and improve access to credit, the formulation of an FSSDP, involving all key stakeholders, is important.

22. Staff welcomes recent progress in structural reforms and encourages the authorities to step up their efforts in promoting private sector development. The recent launch of national identification cards, if successfully completed, would facilitate developing credit rating services and help to improve private sector lending. Staff encourages the authorities to continue their collaboration with the World Bank to further improve access to land; facilitate cross-border trade with South Africa by strengthening coordination of cross-border agencies; and establish a credit reporting bureau.

23. Staff welcomes the authorities' interest in maintaining program relations with the IMF.

Despite progress made under the current arrangement, Lesotho continues to face a challenging structural reform agenda and needs to preserve macroeconomic stability. A significant part of the reform agenda falls within the core areas of the IMF's expertise, such as: (i) ensuring medium-term fiscal and external sustainability; (ii) assisting with the PFM reforms; and (iii) supporting financial sector reforms. Promoting inclusive growth and increasing private sector employment are also important macro-critical agenda items. Program relations with the IMF could also help maintain fiscal discipline, while addressing structural weakness and catalyzing support from Lesotho's international partners.

24. Staff supports the authorities' request for the completion of the sixth and final review under the ECF arrangement.

Table 1. Lesotho: Selected Economic Indicators, 2009/10–17/18¹

	2009/10	2010/11	2011/12	2012/13		2013/14		2014/15	2015/16	2016/17	2017/18
	Act.	Est.	Est.	EBS/13/46 ²	Proj.	EBS/13/46 ²	Proj.	Projections			
Population (1,000; 2011 est.)	2,194										
GNI per capita (U.S. dollars; 2011 est.);	1,220										
Poverty rate (Percent, 2005 est.);	56.6										
(Percentage changes; unless otherwise indicated)											
National account and prices											
GDP at constant prices	4.7	6.8	5.4	3.6	4.3	4.4	4.0	5.3	4.5	4.1	5.0
GDP deflator	3.9	4.6	7.5	5.5	4.7	10.7	11.4	9.8	9.2	6.9	7.2
GDP at market prices											
(Maloti millions)	14,945	16,684	18,896	20,653	20,637	23,871	23,912	27,634	31,544	35,095	39,521
Consumer prices (average)	5.9	3.4	6.0	5.6	5.6	6.2	6.5	6.2	6.0	5.9	5.9
External sector											
Terms of trade (deterioration -)	-4.6	4.0	9.0	-7.6	-9.3	7.1	1.0	6.9	1.4	-1.0	0.6
Average exchange rate											
(Local currency per U.S. dollar)	7.8	7.2	7.4	8.5	8.5	...	...	...	...	...	...
Nominal effective exchange rate change (- = depreciation) ³	-0.5	12.2	-1.2	...	-9.1	...	...	...	...	...	...
Real effective exchange rate (- = depreciation) ³	6.4	13.9	0.6	...	-5.9	...	...	...	...	...	...
Current account balance											
(Including official transfers, percent of GDP)	-3.1	-14.5	-24.2	-10.6	-10.4	-14.1	-14.5	-13.0	-11.9	-11.5	-11.4
(Excluding official transfers, percent of GDP)	-37.3	-36.1	-44.0	-43.4	-43.2	-43.5	-43.9	-36.6	-32.5	-31.3	-31.2
Gross international reserves											
(Months of imports)	5.3	3.8	3.5	3.9	4.2	4.6	4.6	4.8	4.9	5.0	5.0
(Percent of M1)	176	144	139	160	189	171	201	208	211	220	213
Money and credit											
Domestic credit to the private sector	20.7	26.9	25.1	36.2	42.2	43.8	36.1	...	...	...	...
Broad money	11.9	1.1	5.0	16.5	0.5	12.5	9.5	...	...	...	...
Interest rate (percent) ⁴	4.5	3.2	2.8	...	2.4	...	...	...	...	...	...
(Percent of GDP; unless otherwise indicated)											
Savings and investment											
Gross capital formation ⁵	29.0	28.6	34.4	38.7	37.2	39.0	39.5	34.4	31.7	30.7	30.8
Government	11.3	12.1	19.4	21.0	19.4	19.1	19.5	15.2	15.5	15.3	16.2
Private	16.6	14.9	14.7	17.4	17.5	19.5	19.6	18.8	15.9	15.1	14.3
National savings	25.8	14.1	10.2	28.2	26.8	24.9	24.9	21.3	19.8	19.2	19.4
Government	11.0	5.7	9.9	25.0	23.8	20.8	21.1	15.3	14.6	15.0	15.7
Private	14.9	8.4	0.4	3.2	3.0	4.1	3.8	6.0	5.2	4.1	3.7
Public debt											
External public debt	37.0	34.4	36.7	43.1	38.0	41.3	37.5	36.1	33.3	32.9	32.7
Domestic debt	33.5	29.7	30.5	37.7	33.4	36.6	33.5	32.6	30.3	30.2	30.3
	3.4	4.7	6.1	5.4	4.6	4.7	4.0	3.4	3.0	2.7	2.4
Central government fiscal operations											
Net lending/borrowing	-3.9	-4.9	-10.3	4.8	5.2	2.0	1.9	2.1	3.8	3.8	3.8
(Excluding grants)	-6.9	-12.1	-17.9	-3.5	-3.0	-4.8	-5.3	-0.1	1.8	1.6	1.7
Non-SACU fiscal balance ⁶	-35.0	-19.9	-22.8	-20.1	-20.6	-19.3	-19.2	-16.0	-13.5	-11.5	-11.2
Revenue	62.4	51.3	50.9	65.5	64.1	61.2	61.5	52.9	49.8	49.3	48.9
Of which: grants	3.0	7.2	7.6	8.2	8.3	6.8	7.2	2.2	2.0	2.2	2.2
Expenses	55.5	44.7	45.9	45.0	42.4	44.1	44.1	39.5	37.2	36.4	35.7
Nonfinancial assets	10.8	11.5	15.2	15.7	16.5	15.1	15.5	11.3	8.7	9.1	9.4

Sources: Lesotho authorities and IMF staff estimates and projections.

¹ The fiscal year runs from April 1 to March 31.² Values as in the fifth ECF review.³ IMF Information Notice System trade-weighted; end of period.⁴ 12-month time deposits rate.⁵ Excluding changes in inventories.⁶ Excluding externally financed capital project.

Table 2. Lesotho: Fiscal Operations of the Central Government, 2009/10–17/18¹

	(Maloti millions)										
	2009/10	2010/11	2011/12	2012/13		2013/14		2014/15	2015/16	2016/17	2017/18
	Actual	Actual	Est.	EBS/13/46 ²	Proj.	EBS/13/46 ²	Proj.	Projections			
Revenue	9,328	8,559	9,616	13,534	13,222	14,605	14,701	14,617	15,705	17,298	19,336
Tax revenue ³	3,185	3,499	4,283	4,860	4,627	5,843	5,855	6,755	7,738	8,662	9,735
Taxes on income, profits, and capital gain	1,772	1,957	2,395	2,638	2,400	3,148	3,159	3,674	4,223	4,740	5,326
Taxes on property	96	106	125	150	150	191	191	215	252	289	325
Taxes on goods and services	1,290	1,414	1,590	1,870	1,818	2,161	2,161	2,469	2,820	3,145	3,546
Taxes on international trade	21	18	151	202	258	336	336	391	436	480	529
Grants	445	1,200	1,437	1,704	1,706	1,631	1,717	613	638	780	862
Budget support	0	372	290	196	196	300	323	180	180	180	190
Project grants	445	828	1,147	1,508	1,510	1,331	1,394	433	458	600	672
Of which: MCC	270	295	575	1,121	1,122	383	400	0	0	0	0
Non-tax revenue	780	1,232	1,143	1,004	923	1,076	1,075	1,383	1,521	1,758	1,975
Property income	217	652	419	247	182	194	193	452	540	606	678
Sales of goods and services	502	530	692	749	741	840	840	895	949	1,115	1,255
Other non-tax revenue	61	50	32	8	0	42	42	36	32	37	43
SACU	4,918	2,628	2,753	5,966	5,966	6,055	6,055	5,866	5,808	6,098	6,763
Of which: volatile component	2,676	125	-82	2,868	2,871	2,474	2,468	1,721	1,076	834	835
Expense	8,293	7,459	8,680	9,298	8,749	10,516	10,546	10,904	11,748	12,764	14,111
Compensation of employees	3,144	3,199	3,638	3,979	3,733	4,625	4,625	4,987	5,383	5,850	6,407
Wages and salaries	2,677	2,881	3,136	3,477	3,226	4,013	4,013	4,357	4,722	5,146	5,608
Social contributions	465	319	503	501	506	612	612	631	661	704	800
Use of goods and services	2,549	1,918	2,177	2,650	2,357	2,976	3,003	2,869	3,119	3,378	3,640
Interest payments	118	96	137	166	165	229	227	268	277	310	385
Domestic	51	43	68	85	85	138	98	129	130	130	155
External	67	53	69	81	80	91	129	138	147	180	230
Subsidies	273	232	237	244	253	234	234	238	239	251	285
Grants	984	707	960	896	882	817	817	840	881	922	1,055
Social benefits	555	600	587	621	613	739	744	818	921	1,046	1,194
Other expenses	670	707	943	742	747	895	895	884	929	1,007	1,145
Gross operating balance	1,035	1,100	936	4,236	4,473	4,089	4,156	3,713	3,957	4,534	5,225
Nonfinancial assets	1,616	1,923	2,877	3,245	3,396	3,614	3,694	3,121	2,759	3,202	3,706
Net lending/borrowing	-581	-822	-1,941	990	1,077	476	461	591	1,199	1,332	1,520
Transactions in financial assets and liabilities	185	-270	-1,449	990	1,702	476	461	591	1,199	1,332	1,520
Financial assets	-178	-663	-870	1,619	1,878	1,156	1,172	1,176	1,274	1,833	2,105
Domestic	-179	-663	-870	1,619	1,878	1,156	1,172	1,176	1,272	1,832	2,104
Deposits	-179	-666	-870	1,619	1,878	1,156	1,172	1,176	1,272	1,832	2,104
Central bank	-163	-646	-870	1,619	1,670	1,156	1,172	1,176	1,272	1,832	2,104
Commercial banks	-16	-21	0	0	208	0	0	0	0	0	0
Loans	0	3	0	0	0	0	0	0	0	0	0
Foreign	-1	0	0	0	0	0	0	0	0	0	0
Financial liabilities	-363	-393	579	629	175	681	711	585	75	501	585
Domestic	-382	-320	413	45	-208	0	0	0	0	0	0
Foreign	20	-73	166	584	384	681	711	585	75	501	585
Disbursements	274	128	388	822	632	963	1,008	850	356	745	829
Amortization	-254	-201	-222	-238	-249	-282	-297	-265	-281	-245	-244
Statistical discrepancy ⁴	-766	-552	-492	0	-626	0	0	0	0	0	0
<i>Memorandum items:</i>											
Recurrent expenditure	7,136	6,385	7,492	8,063	8,022	9,302	9,304	10,050	10,738	11,440	12,579
Capital expenditure	2,774	2,996	4,065	4,481	4,123	4,828	4,936	3,976	3,769	4,525	5,238
Domestically financed	2,055	1,884	2,530	2,151	1,981	2,534	2,534	2,693	2,955	3,180	3,736
Externally financed	719	956	1,534	2,330	2,142	2,294	2,402	1,284	814	1,345	1,501
Non-SACU fiscal balance, including foreign-financed capital projects	-5,499	-3,450	-4,694	-4,976	-4,890	-5,579	-5,593	-5,275	-4,609	-4,766	-5,244
Non-SACU fiscal balance, excluding foreign-financed capital projects	-5,226	-3,323	-4,307	-4,154	-4,257	-4,616	-4,585	-4,424	-4,254	-4,021	-4,415
Core SACU fiscal balance (ex. volatile SACU and foreign project loans) ⁵	-2,984	-820	-1,472	-1,056	-1,162	-1,036	-998	-279	478	1,244	1,513

Sources: Lesotho authorities and IMF staff estimates and projections.

¹ The fiscal year runs from April 1 to March 31.² Values as in the fifth ECF review.³ Other taxes are not shown in the table.⁴ The remaining balances on non-Treasury accounts at the end of the fiscal year explain the bulk of the statistical discrepancy.⁵ Core SACU revenue is set at 15 percent of GDP, close to the lowest historical level, far below the historical average (26 percent of GDP for the last 20 years).

Table 3. Lesotho: Fiscal Operations of the Central Government, 2009/10–17/18¹

	(Percent of GDP)										
	2009/10	2010/11	2011/12	2012/13		2013/14		2014/15	2015/16	2016/17	2017/18
	Actual	Actual	Est.	EBS/13/46 ²	Proj.	EBS/13/46 ²	Proj.	Projections			
Revenue	62.4	51.3	50.9	65.5	64.1	61.2	61.5	52.9	49.8	49.3	48.9
Tax revenue ³	21.3	21.0	22.7	23.5	22.4	24.5	24.5	24.4	24.5	24.7	24.6
Taxes on income, profits, and capital gain	11.9	11.7	12.7	12.8	11.6	13.2	13.2	13.3	13.4	13.5	13.5
Taxes on property	0.6	0.6	0.7	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.8
Taxes on goods and services	8.6	8.5	8.4	9.1	8.8	9.1	9.0	8.9	8.9	9.0	9.0
Taxes on international trade	0.1	0.1	0.8	1.0	1.2	1.4	1.4	1.4	1.4	1.4	1.3
Grants	3.0	7.2	7.6	8.2	8.3	6.8	7.2	2.2	2.0	2.2	2.2
Budget Support	0.0	2.2	1.5	0.9	1.0	1.3	1.4	0.6	0.6	0.5	0.5
Project grants	3.0	5.0	6.1	7.3	7.3	5.6	5.8	1.6	1.5	1.7	1.7
Of which: MCC	3.4	1.8	3.0	5.4	5.4	1.6	1.7	0.0	0.0	0.0	0.0
Non-tax revenue	5.2	7.4	6.0	4.9	4.5	4.5	4.5	5.0	4.8	5.0	5.0
Property income	1.5	3.9	2.2	1.2	0.9	0.8	0.8	1.6	1.7	1.7	1.7
Sales of goods and services	3.4	3.2	3.7	3.6	3.6	3.5	3.5	3.2	3.0	3.2	3.2
Other non-tax revenue	0.4	0.3	0.2	0.0	0.0	0.2	0.2	0.1	0.1	0.1	0.1
SACU	32.9	15.8	14.6	28.9	28.9	25.4	25.3	21.2	18.4	17.4	17.1
Of which: volatile component	17.9	0.8	-0.4	13.9	13.9	10.4	10.3	6.2	3.4	2.4	2.1
Expense	55.5	44.7	45.9	45.0	42.4	44.1	44.1	39.5	37.2	36.4	35.7
Compensation of employees	21.0	19.2	19.3	19.3	18.1	19.4	19.3	18.0	17.1	16.7	16.2
Wages and salaries	17.9	17.3	16.6	16.8	15.6	16.8	16.8	15.8	15.0	14.7	14.2
Social contributions	3.1	1.9	2.7	2.4	2.5	2.6	2.6	2.3	2.1	2.0	2.0
Use of goods and services	17.1	11.5	11.5	12.8	11.4	12.5	12.6	10.4	9.9	9.6	9.2
Health care	1.9	1.7	2.7	3.8	3.8	3.5	3.5	3.2	3.2	3.2	3.2
Interest payments	0.8	0.6	0.7	0.8	0.8	1.0	1.0	1.0	0.9	0.9	1.0
Domestic	0.3	0.3	0.4	0.4	0.4	0.6	0.4	0.5	0.4	0.4	0.4
External	0.4	0.3	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.6
Subsidies	1.8	1.4	1.3	1.2	1.2	1.0	1.0	0.9	0.8	0.7	0.7
Grants	6.6	4.2	5.1	4.3	4.3	3.4	3.4	3.0	2.8	2.6	2.7
Social benefits	3.7	3.6	3.1	3.0	3.0	3.1	3.1	3.0	2.9	3.0	3.0
Other expenses	4.5	4.2	5.0	3.6	3.6	3.8	3.7	3.2	2.9	2.9	2.9
Gross operating balance	6.9	6.6	5.0	20.5	21.7	17.1	17.4	13.4	12.5	12.9	13.2
Non-financial assets	10.8	11.5	15.2	15.7	16.5	15.1	15.5	11.3	8.7	9.1	9.4
Net lending(+)/borrowing (-)	-3.9	-4.9	-10.3	4.8	5.2	2.0	1.9	2.1	3.8	3.8	3.8
Transactions in financial assets and liabilities	1.2	-1.6	-7.7	4.8	8.2	2.0	1.9	2.1	3.8	3.8	3.8
Financial assets	-1.2	-4.0	-4.6	7.8	9.1	4.8	4.9	4.3	4.0	5.2	5.3
Domestic	-1.2	-4.0	-4.6	7.8	9.1	4.8	4.9	4.3	4.0	5.2	5.3
Deposits	-1.2	-4.0	-4.6	7.8	9.1	4.8	4.9	4.3	4.0	5.2	5.3
Central bank	-0.1	-0.1	0.0	0.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial banks	-1.1	-3.9	-4.6	7.8	8.1	4.8	4.9	4.3	4.0	5.2	5.3
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial liabilities	-2.4	-2.4	3.1	3.0	0.8	2.9	3.0	2.1	0.2	1.4	1.5
Domestic	-2.6	-1.9	2.2	0.2	-1.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.1	-0.4	0.9	2.8	1.9	2.9	3.0	2.1	0.2	1.4	1.5
Disbursements	1.8	0.8	2.1	4.0	3.1	4.0	4.2	3.1	1.1	2.1	2.1
Amortization	-1.7	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2	-1.0	-0.9	-0.7	-0.6
Statistical discrepancy ⁴	-5.1	-3.3	-2.6	0.0	-3.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Memorandum items:</i>											
Recurrent expenditure	47.7	38.3	39.6	39.0	38.9	39.0	38.9	36.4	34.0	32.6	31.8
Capital expenditure	18.6	18.0	21.5	21.7	20.0	20.2	20.6	14.4	11.9	12.9	13.3
Domestically financed	13.8	11.3	13.4	10.4	9.6	10.6	10.6	9.7	9.4	9.1	9.5
Externally financed	4.8	6.7	8.1	11.3	10.4	9.6	10.0	4.6	2.6	3.8	3.8
Non-SACU fiscal balance, including foreign financed capital projects	-36.8	-20.7	-24.8	-24.1	-23.7	-23.4	-23.4	-19.1	-14.6	-13.6	-13.3
Non-SACU fiscal balance, excluding foreign financed capital projects	-35.0	-19.9	-22.8	-20.1	-20.6	-19.3	-19.2	-16.0	-13.5	-11.5	-11.2
Core SACU fiscal balance (ex. volatile SACU and foreign project loans) ⁵	-20.0	-4.9	-7.8	-5.1	-5.6	-4.3	-4.2	-1.0	1.5	3.5	3.8

Sources: Lesotho authorities and IMF staff estimates and projections.

¹ The fiscal year runs from April 1 to March 31.² Values as in the fifth ECF review.³ Other taxes are not shown in the table.⁴ The remaining balances on non-Treasury accounts at the end of the fiscal year explain the bulk of the statistical discrepancy.⁵ Core SACU revenue is set at 15 percent of GDP, close to the lowest historical level, far below the historical average (26 percent of GDP for the last 20 years).

Table 4. Lesotho: Monetary Accounts, 2011–14^{1, 2}
(Maloti millions; unless otherwise indicated)

	2011		2012			2013		2014	
	Mar.	Mar.	Jun.	Sept.	Dec.	Mar.	Sept.	Mar.	
	Act.	Act.	Act.	Act.	Act.	EBS/13/46 ³	Act.	Proj.	Proj.
Depository corporations survey									
Net foreign assets	9,304	8,801	8,706	9,374	10,141	10,400	10,123	10,758	10,936
Central bank	5,801	5,975	5,903	7,016	7,654	7,782	7,985	8,629	9,274
Commercial banks	3,503	2,827	2,803	2,358	2,487	2,619	2,138	2,128	1,663
Net domestic assets	-3,091	-2,277	-1,858	-2,685	-2,992	-2,796	-3,564	-3,617	-3,753
Claims on central government (net)	-2,922	-1,729	-2,067	-2,680	-3,149	-3,273	-3,631	-4,217	-4,803
Central bank	-3,477	-2,568	-2,908	-3,555	-3,986	-4,187	-4,238	-4,823	-5,409
Commercial banks	555	839	841	875	837	914	606	606	606
Claims on private sector	2,326	2,909	3,143	3,473	3,778	3,963	4,136	4,820	5,628
Other items (net)	-2,501	-3,458	-2,937	-3,478	-3,621	-3,486	-4,069	-4,219	-4,578
Broad money	6,213	6,525	6,848	6,689	7,149	7,604	6,559	7,141	7,183
Currency outside banks	529	643	722	734	769	879	792	872	803
Deposits	5,683	5,881	6,127	5,955	6,380	6,725	5,768	6,269	6,380
<i>Memorandum items:</i>	(12-month percentage change; unless otherwise indicated)								
Reserve money	-19.7	16.8							
Broad money	1.1	5.0	8.6	-4.6	6.7	16.5	0.5	6.8	9.5
Credit to the private sector	26.9	25.1	29.2	32.7	40.6	36.2	42.2	38.8	36.1
Credit to the private sector (percent of GDP)	12.3	14.1	15.2	16.8	18.3	16.6	17.3	17.4	20.4
Velocity (GDP/broad money)	3.0	3.2	3.0	3.1	2.9	3.1	3.1	3.3	3.3

Sources: Lesotho authorities and IMF staff estimates and projections.

¹ The fiscal year runs from April 1 to March 31.

² Including valuation changes.

³ Values as in the fifth ECF review.

Table 5. Lesotho: Balance of Payments, 2009/10–17/18¹

(US\$ millions; unless otherwise indicated)

	2009/10	2010/11	2011/12	2012/13		2013/14		2014/15	2015/16	2016/17	2017/18
	Act.	Est.	Est.	EBS/13/46 ²	Proj.	EBS/13/46 ²	Proj.	Projections			
Current account	-60	-336	-613	-258	-251	-362	-364	-360	-355	-363	-384
Trade balance	-951	-1,062	-1,086	-1,170	-1,164	-1,174	-1,180	-1,007	-889	-910	-955
Exports, f.o.b.	779	951	1,097	1,062	1,012	1,223	1,040	1,238	1,367	1,433	1,516
Imports, f.o.b.	-1,730	-2,013	-2,183	-2,232	-2,176	-2,398	-2,219	-2,245	-2,256	-2,343	-2,470
Services (net)	-417	-495	-524	-466	-462	-452	-435	-448	-481	-459	-471
Income (net)	512	551	316	411	414	350	353	279	224	204	187
Of which: interest on public debt	-8	-7	-7	-10	-10	-10	-14	-14	-14	-16	-17
Transfers	796	671	680	966	961	915	897	817	792	802	855
Official transfers	652	501	504	802	798	752	738	650	618	621	666
Other transfers	144	169	176	164	163	163	159	166	174	181	189
Capital and financial account	25	15	308	410	441	527	476	459	426	469	407
Capital account	84	55	142	156	155	125	129	101	165	189	193
Financial account	-58	-40	165	254	285	402	347	357	261	280	214
Foreign direct	109	120	137	201	200	273	263	282	228	219	210
Portfolio investment	0	0	0	0	0	0	0	0	0	0	0
Other investment	-167	-159	28	53	86	129	84	75	32	61	4
Medium and long-term	-167	-159	28	53	86	129	84	75	32	61	4
Of which:											
Public sector (net)	2	-10	22	69	45	73	75	58	7	45	53
Disbursements	35	18	52	97	74	103	106	85	34	67	90
Amortization	-32	-28	-30	-28	-29	-30	-31	-26	-27	-22	-37
Short-term	0	0	0	0	0	0	0	0	0	0	0
Errors and omissions	-6	70	333	0	54	0	0	0	0	0	0
Overall balance	-40	-250	28	152	244	165	112	99	71	106	23
Financing	40	250	-28	-152	-244	-165	-112	-99	-71	-106	-23
<i>Memorandum items:</i>											
						(Percent of GDP)					
Current account	-3.1	-14.5	-24.2	-10.6	-10.4	-14.1	-14.5	-13.0	-11.9	-11.5	-11.4
Trade balance	-49.8	-45.8	-42.8	-47.9	-48.0	-45.8	-47.0	-36.5	-29.7	-28.9	-28.4
Capital and financial account	1.3	0.7	12.1	16.8	18.2	20.6	19.0	16.6	14.3	14.9	12.1
Overall balance	-2.1	-10.8	1.1	6.2	10.0	6.5	4.5	3.6	2.4	3.4	0.7
Gross international reserves											
(US\$ millions) ³	1,105	961	858	970	990	1,145	1,103	1,173	1,220	1,296	1,289
(Months of imports)	5.3	3.8	3.5	3.9	4.2	4.6	4.6	4.8	4.9	5.0	5.0

Sources: Lesotho authorities and IMF staff estimates and projections.

¹ The fiscal year runs from April 1 to March 31.² Values as in the fifth ECF review.³ Including the SDR allocation in 2009.

Table 6. Lesotho: Commercial Bank Performance Ratios, 2005–13

(As of end-December; percent)

	2005	2006	2007	2008	2009	2010	2011	2012	Mar-13
I. Capital adequacy									
a) Basel capital ratio	22.0	19.0	14.2	13.7	13.5	14.9	16.0	14.0	19.0
b) Nonperforming loans net of provisions to capital	0.3	-5.4	-13.4	-13.5	-9.3	0.5	-6.3	-6.6	-4.4
c) Top 20 exposures to statutory capital and reserves	220	386	465	306	359	522	528	467	482
II. Asset quality									
a) Loans to deposit ratio	29.0	24.9	28.6	29.1	32.4	35.4	43.6	57.1	61.9
b) Earning assets to total assets	93.0	90.3	89.7	88.3	86.0	91.3	92.0	88.3	90.9
c) Nonperforming loans to total assets	2.0	2.0	1.4	2.1	3.2	3.1	2.2	2.5	2.7
d) Reserve for losses to total loans	3.0	2.8	2.6	4.0	4.3	3.1	2.7	3.0	3.0
e) Reserve for losses to nonperforming loans	167.0	131.8	193.0	195.7	136.2	98.3	124.0	117.3	109.9
III. Liquidity									
a) Liquidity assets to total deposits	120	101	92	95	95	99	96	77	87
b) Available reserves to total deposits	8.0	3.5	3.4	1.9	3.5	3.6	2.3	3.0	3.3
c) Liquid assets to total assets	77	78	73	72	70	72	68	56	58
d) Current assets to current liabilities	86	105	107	106	107	108	109	111	111
IV. Profitability									
a) Net interest margin	...	4.5	5.6	6.8	6.2	5.2	5.4	6.6	1.9
b) Cost to income	...	65	63	58	56	56	58	59	61
c) Return on assets (ROA)	2.0	0.3	1.7	2.8	2.8	2.7	2.8	3.1	1.0
d) Return on equity	15.0	4.5	21.0	38.4	33.3	30.9	29.0	27.9	8.7

Source: Central Bank of Lesotho.

Table 7. Lesotho: Indicators of Capacity to Repay the IMF¹

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	Actual			Projections									
IMF obligations based on existing credit													
(Millions of SDRs)													
Principal	4.6	4.9	3.9	2.5	1.4	0.4	0.8	2.1	4.7	8.4	9.0	8.2	6.9
Charges and interest	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.0	0.0
IMF obligations based on existing and prospective credit													
(Millions of SDRs)													
Principal	4.6	4.9	3.9	2.5	1.4	0.4	0.8	2.1	4.7	9.0	10.1	9.4	8.0
Charges and interest	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Total obligations based on existing and prospective credit													
Millions of SDRs													
Millions of US\$	4.6	4.9	3.9	2.5	1.4	0.4	0.9	2.3	4.8	9.1	10.1	9.4	8.0
Percent of exports of goods and services	7.3	7.6	6.2	3.9	2.2	0.6	1.4	3.6	7.6	14.3	16.0	14.8	12.6
Percent of debt service	0.9	0.8	0.6	0.4	0.2	0.0	0.1	0.2	0.5	0.9	0.9	0.7	0.5
Percent of GDP	15.4	18.3	12.9	8.0	4.0	1.0	2.7	7.1	14.3	29.1	28.8	30.4	24.1
Percent of gross international reserves	0.4	0.3	0.2	0.2	0.1	0.0	0.0	0.1	0.2	0.3	0.4	0.3	0.2
Percent of quota	0.7	0.8	0.7	0.4	0.2	0.0	0.1	0.3	0.6	0.9	0.9	0.8	0.6
	13.3	14.1	11.2	7.0	4.0	1.0	2.6	6.4	13.8	26.0	29.1	26.8	23.0
Outstanding IMF credit													
Millions of SDRs													
Millions of US\$	13.3	16.2	18.0	41.4	51.3	50.6	49.8	47.7	43.0	34.6	24.5	15.1	7.1
Percent of exports of goods and services	20.7	25.4	28.8	65.7	81.4	80.1	78.7	75.3	67.8	54.6	38.6	23.8	11.2
Percent of debt service ²	2.5	2.6	2.5	6.3	7.6	6.3	5.6	5.2	4.4	3.3	2.1	1.1	0.5
Percent of GDP	43.6	61.6	59.7	135.1	147.8	150.6	148.9	151.4	126.8	110.7	69.4	49.0	21.4
Percent of gross international reserves	1.1	1.1	1.1	2.7	3.2	2.9	2.6	2.4	1.7	1.3	0.9	0.5	0.2
Percent of quota	1.9	2.6	3.4	6.6	7.4	6.8	6.4	5.8	5.3	3.4	2.1	1.2	0.6
	38.1	46.4	51.7	118.5	147.0	145.0	142.8	136.7	123.2	99.1	70.1	43.3	20.4
Net use of IMF credit (millions of SDRs)													
Disbursements	-4.6	2.9	1.8	23.3	10.0	-0.4	-0.8	-2.1	-4.7	-9.0	-10.1	-9.4	-8.0
Repayments	0.0	7.8	5.7	25.8	11.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	4.6	4.9	3.9	2.5	1.4	0.4	0.8	2.1	4.7	9.0	10.1	9.4	8.0
<i>Memorandum items:</i>													
Exports of goods and services (millions of US\$)	813	984	1,130	1,043	1,069	1,267	1,395	1,460	1,541	1,666	1,860	2,078	2,324
Debt service (millions of US\$) ²	47.5	41.2	48.2	48.6	55.0	53.2	52.9	49.7	53.5	49.3	55.6	48.6	52.4
Nominal GDP (millions of US\$)	1,911	2,319	2,536	2,426	2,510	2,757	2,990	3,148	3,900	4,176	4,473	4,791	5,131
Gross international reserves (millions of US\$)	1,105	961	858	990	1,103	1,173	1,220	1,296	1,289	1,585	1,827	1,909	1,994
Quota (millions of SDRs)	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9
Sources: IMF staff estimates and projections.													
¹ The fiscal year runs from April 1 to March 31.													
² Total debt service includes IMF repayments.													

Table 8. Lesotho: Schedule of ECF Disbursements and Reviews, 2011–13¹

Date	Conditions	Original ECF Disbursement		ECF Augmentation		Total Disbursement	
		Millions of SDRs	Percent of quota ²	Millions of SDRs	Percent of quota ²	Millions of SDRs	Percent of quota ²
9-Jun-10	Executive Board approval	7.800	22.3	-	-	7.800	22.3
7-Apr-11	Completion of the first review on a lapse-of time basis, based on observance of performance criteria through September 30, 2010	5.680	16.3	-	-	5.680	16.3
17-Apr-12	Completion of combined second and third reviews, based on observance of performance criteria through end-March 31, 2011, and end-September 30, 2011	11.360	32.6	8.725	25.0	20.085	57.6
6-Dec-12	Completion of fourth review, based on observance of performance criteria through March 31, 2012	5.680	16.3	-	-	5.680	16.3
17-May-13	Completion of fifth review, based on observance of performance criteria through September 30, 2012	5.680	16.3	-	-	5.680	16.3
13-Sep-13	Completion of sixth review, based on observance of performance criteria through March 31, 2013	5.680	16.3	-	-	5.680	16.3
Total		41.880	120.0	8.725	25.0	50.605	145.0

Source: IMF staff estimates.

¹ Disbursements are expected to take place shortly after Board meeting.

² Lesotho's quota is SDR 34.9 million.

Appendix I. Letter of Intent

August 14 , 2013

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431
United States of America

Dear Ms. Lagarde:

This letter and the attached Memorandum of Economic and Financial Policies (MEFP) update and supplement my communication of April 20, 2012, describe performance under the government's economic program, and provide an update on our economic policies for 2013/14.

Our performance under the program supported under the Extended Credit Facility (ECF) has remained strong. We met all the end-March 2013 performance criteria and indicative targets (Table 1, MEFP). Although we are fully committed to our structural reforms under the program, administrative setbacks resulted in a delay in the completion of structural benchmarks (SBs), with one SB met with delay (the establishment of a cash management unit (CMU) in the treasury) and two others still in progress (the reconciliation of all treasury accounts on a monthly basis and the production of a monthly monitoring report; and the submission of the Public Debt Management Bill to Parliament). The reconciliation of all treasury accounts has been delayed, owing to the inability of line ministries and agencies to provide the reconciled bank statements. To enforce this important requirement under the Public Financial Management Act (PFMA), the Ministry of Finance, on a selective basis, has begun freezing accounts for which statements are not submitted. The CMU has been established since end-July, following a delay in the recruitment of all staff for that unit. Following internal consultations between the Ministry of Finance and the Central Bank of Lesotho, the draft Public Debt Management Bill has recently been sent to the attorney general for certification before final cabinet clearance and submission to Parliament. The bill is expected to be submitted to Parliament in September 2013 when Parliament reconvenes.

We therefore request completion of the sixth review of the ECF-supported program and associated disbursement, based on overall performance under the program and the government's policy intentions going forward. We consent to the publication, including on the IMF website, of this letter of intent, the attached MEFP, and the accompanying staff report.

The ECF arrangement has played an important role in the consolidation of macroeconomic stability following a series of exogenous shocks, mainly the decline in SACU revenues and adverse climatic conditions in 2010–12. Relatively robust growth has been maintained under the arrangement, which has helped to restore fiscal and external sustainability and facilitate structural reforms.

In light of our successes under the current ECF arrangement and given remaining challenges, particularly with respect to public financial management, the civil service reform and financial sector development, the government intends to continue implementing reforms, with the support of the IMF under a possible successor three-year arrangement. The government, therefore, plans to start negotiations with the IMF in the coming months.

To facilitate broad national dialogue on a key medium-term economic reform agenda, we plan to hold a national seminar in October 2013. The outcome of the dialogue would inform economic policies and reforms supported under a possible new three-year arrangement with the IMF.

Yours sincerely,

/s/

Hon. Dr. Leketekete Victor Ketso,
Minister of Finance

/s/

Dr. Rets'elisitsoe Matlanyane
Governor of the Central Bank of Lesotho

Attachments

Attachment I. Memorandum of Economic and Financial Policies

I. Recent Economic Developments and Outlook

1. Despite the drought, Lesotho maintained robust growth in 2012/13, largely driven by construction. Annual inflation has subsided to 4.6 percent in June 2013 in response to the continued easing of international commodity prices. Supported by the progress in fiscal consolidation and recovery of revenues from the Southern African Customs Union (SACU), the external balances continue to recover, with gross international reserves reaching US\$1 billion, equal to 4¼ months of imports, at end-April 2013, up from 3½ months of imports in April 2012.

2. We achieved an estimated fiscal surplus of 5¼ percent of GDP in 2012/13, while safeguarding spending on vulnerable groups and some priority infrastructure. Our core SACU fiscal deficit (excluding externally financed capital projects) is estimated at 5⅔ percent of GDP,¹ helping to restore macroeconomic stability and further improve international reserves. These objectives were achieved by reducing non-priority outlays through stricter expenditure control. Tax revenues fell short of our projections, partly because investment cost in the mining sector reduced the corporate income tax.

3. In the coming years, we are expecting robust economic growth to continue, though the Lesotho economy continues to face downside risks. The growth prospects—above 4 percent—will be supported by recovery in agricultural production and continued expansion of diamond mining activities. The prospects, however, are subject to downside risks from uncertainties associated with the global and South African economies. Specifically, the uncertain global economic outlook poses risks to the regional economy and future SACU revenue, as well as external demand for Lesotho's key exports—diamonds and textiles. The low level of international diamond prices—which are already lowering export receipts—may also undermine the prospects of the mining industry. Exports of textiles could be affected by the impending expiration that the African Growth and Opportunity Act (AGOA) trade preferences will expire in 2015, though we are optimistic that the adverse impact will be mitigated by enhancing exports to the region and other areas (non AGOA exports).

¹ The core SACU fiscal balance—defined as the fiscal balance excluding the volatile component of SACU revenue and foreign-financed project loans—is the key policy anchor for fiscal consolidation efforts. The volatile component of SACU revenue is defined as the total SACU revenue minus the core component equal to 15 percent of GDP, which is close to the lowest annual SACU receipt in the last two decades.

II. Performance Under the Program

4. Overall performance under the ECF-supported program has been strong. We have met all the end-March 2013 quantitative performance criteria and indicative targets (Table 1). Despite our continued efforts on structural reforms, implementation of structural benchmarks (SBs) has been delayed through May 2013, with one SB met with delay and two others uncompleted (Table 2).

- i. The cash management unit (CMU) has been established since end-July, following some delay in the recruitment process of staff for that unit. The CMU has been staffed, and an operational manual has been prepared based on assistance from AFRITAC South. Following its establishment, further IMF technical assistance has been provided to strengthen cash management operations.
- ii. The reconciliation of the government's bank accounts has been delayed. Currently, government expenditure accounts held at the Central Bank of Lesotho (CBL) are being reconciled on a daily basis. The reconciliation of the commercial bank accounts and government revenue through the main revenue account (MRA) has been delayed, owing to challenges with the IFMIS and failures of budgetary agencies to submit necessary information for the reconciliation. The government is taking appropriate measures to resolve the problem, including the suspension of accounts, where ministries have not been compliant. We have also recently finalized the treasury regulations, which will help with the implementation of the PFMA, including the strengthening of the requirement for chief accounting officers to submit reconciled monthly financial statements.
- iii. The Public Debt Management Bill will be submitted to Parliament by end-September 2013, notwithstanding the delays in concluding internal consultations on the operational aspects of this bill. The draft Public Debt Management Bill has recently been sent to the attorney general for certification before cabinet policy clearance and submission to Parliament.

III. Macroeconomic Policies Under the Program

5. We remain committed to achieving fiscal and external sustainability over the medium term, while addressing our development and social needs. As a small open economy, Lesotho is prone to exogenous shocks, and it will continue to benefit from the exchange rate regime fixed to the South African rand. We therefore continue to aim at securing an adequate level of international reserves for such future shocks (equal to above five months of imports).

6. Building on the progress in securing fiscal and external sustainability, we are committed to promoting private sector development, to further reduce poverty and make growth more sustained and broad based. As an implementation strategy for the National Vision 2020, the National Strategic Development Plan (NSDP) seeks to (i) pursue economic growth that is high, shared, and job-creating; (ii) develop priority infrastructure; (iii) enhance the

country's skills base, technology adoption, and foundations for innovation; (iv) improve health, combat HIV/AIDS, and reduce (social) vulnerability; (v) reverse environmental degradation and adapt to climate change; and (vi) promote peace and democratic governance and build effective institutions. To effectively implement the National Strategic Development Plan (NSDP), we recently finalized the *Public Sector Investment Programme* (PSIP), the *Implementation Plan*, and the *Monitoring and Evaluation Framework*. Subsequently, the government has initiated a dialogue with international partners to mobilize resources to assist the implementation of the NSDP. To strengthen social protection, we plan to develop a Social Protection Strategy to lay out the overall objectives of the Social Protection programs.

Macroeconomic Policies for 2013/14

7. We target at achieving sustained growth, while we remain committed to rebuilding international reserves buffer in support of our exchange rate peg to the South African rand. We will therefore maintain our fiscal consolidation efforts, while supporting economic growth and employment, protecting vulnerable groups, and proceeding with priority infrastructure projects under the NSDP. We aim to achieve our targeted deficit limit in the core SACU fiscal surplus of 4¼ percent of GDP for 2013/14. This target would facilitate adequate capital spending for growth, while we pursue further rationalization and efficiencies in recurrent spending (particularly on the wage bill and on goods and services) and strengthen revenue administration. With these consolidation efforts, the external balances are expected to further improve, and gross international reserves would reach US\$1.1 billion, equal to 4⅔ months of imports by March 2014.

8. In pursuit of our fiscal consolidation, we intend to (i) limit the filling of vacant posts and contain creation of new positions to a few posts (mainly at newly created ministries²), (ii) reduce non-priority outlays through stricter expenditure control, (iii) limit contingency spending to emergencies, and (iv) implement revenue administration measures following the completion of the Lesotho Revenue Authority (LRA) restructuring. While we continue to restrain the overall wage bill, we have provided increases in wages and salaries to retain technically skilled workers, regularized the wage structure, and brought wages and salaries closer to the minimum income level for the lower grades. During the coming years, with the assistance of the World Bank, the government intends to undertake a full civil service audit, which would determine the exact number of public servants and assist in the clean-up of the payroll. The government will further conduct a review of the civil service to determine the optimal size of the civil service and restructuring needs to improve efficiency of the public sector and help achieve the goals of the NSDP.

² These include the ministries of development planning, mining, and social development.

Structural Reforms

Enhancing Revenue Administration

9. To improve domestic revenue collection, we will continue to strengthen tax administration and broaden the tax base. As a part of restructuring of the LRA, a full-service large tax payer unit has been established. Furthermore, the LRA has been undertaking further efforts to improve recovery of unpaid taxes, expand the taxpayer's registration, and strengthen compliance and service delivery. The government plans to undertake a comprehensive review of the income taxes and the VAT to improve tax efficiency. With IMF technical assistance, we also aim to review the mining taxation regime by fall-2013 to ensure that the regime is consistent with international best practices.

Improving Public Financial Management (PFM)

10. Notwithstanding the challenges that we face in cash management and treasury reconciliation, we have made further progress in improving the regulatory frameworks and institutional management of PFM reforms, based on the PFM action plan.³ The treasury regulations are at a final stage and soon will be sent to Parliament for adoption. These regulations—assisting the implementation of the PFMA Act—are expected to further ensure that chief accounting officers of line ministries submit reconciled monthly financial statements. The Audit Act is also being finalized and has been submitted to Parliament. This act will enforce the timely submission of audits to Parliament, in light of the backlog of unaudited public accounts for 2010/11 and 2011/12. To ensure the timely implementation of the PFM Action Plan, the secretariat for the plan has been identified, and, with funding from the EU, the IMF will support a technical assistance expert to assist the secretariat. Areas of technical assistance in PFM are being coordinated with Lesotho's international partners (e.g., IMF, EU, World Bank, AfDB). Furthermore, the Ministry of Finance plans to strengthen the monitoring and oversight of public agencies' financial reporting, as envisaged under the PFMA Act.

Strengthening Debt Management

11. We have made progress in strengthening debt management. With technical assistance from the IMF, legislation is being formulated to safeguard debt sustainability and modernize the debt management framework. Based on the Debt Management Performance Assessment (DEMPA), we are developing a broader reform plan and a medium-term debt

³ This plan—prepared with assistance by the IMF's Fiscal Affairs Department (FAD) and AFRITAC South and in full coordination with all the key donors—details the reform deliverables for the next three years. The reforms aim at achieving the following objectives: (i) developing and implementing a modern PFM regulatory framework; (ii) improving transparency and effectiveness of fiscal policy by enhancing macro-fiscal projections and strengthening the links between fiscal strategy and budget appropriations; (iii) strengthening internal controls, accounting and fiscal reporting to achieve full compliance with the regulatory framework; and (iv) improving governance and institutional management of PFM reforms.

management strategy, with the assistance from the World Bank. Because of our moderate risk of debt distress, we will continue to seek external financing through grants and concessional loans to support the implementation of the NSDP. Looking forward, we also are assessing options for the medium-term financing of the second phase of the Lesotho Highlands Water Project, which may not be available on concessional terms. To focus on key priority projects with high economic rates of return and consistent with Lesotho's debt service capacity (to avoid debt distress), all capital projects continue to be appraised by the project appraisal committee before being allocated in the budget.

Supporting Financial Sector Development

12. We will continue our efforts to strengthen the legal and regulatory frameworks necessary for financial deepening. The new Financial Institutions Act (FIA) has empowered the CBL to regulate and supervise nonbank financial institutions (money lenders, foreign exchange bureaus, microfinance institutions, cooperative banks). Supported by IMF TA, we are finalizing a draft of revised banking regulations under the Financial Institutions Act 2012 (including licensing regulations, asset classification regulations, liquidity requirements regulations, lending limits regulations). Based on further technical assistance from the IMF, other financial institutions regulations (e.g., risk management regulations, prompt corrective action regulations, disclosure of financial information regulations) are being developed, and we will also improve supervision and regulation of the insurance sector. Moreover, we have been closely monitoring potential risks associated with a rapid private sector credit growth. To this end, we will review the adequacy of our current loan classification, provisioning rules, and collateral valuation practices. In accordance with the NSDP, we aim to review and improve other related legal frameworks, including pension legislation, bankruptcy, and leasing laws. These measures will help improve confidence in the financial system and further spur financial sector development. More broadly, to facilitate financial intermediation and promote private sector development and inclusive growth, we have, with assistance from the IMF and World Bank, prepared a comprehensive draft Financial Sector Strategic Development Plan (FSSDP) that we expect to be finalized by September 2013.

Improving Investment Climate

13. We have embarked on implementing measures to promote private sector development, in a comprehensive plan to improve the business climate in the NSDP. In collaboration with the World Bank, we will seek to improve the business climate and promote private sector development, specifically in accessing land, obtaining construction permits, engaging in cross-border trade with South Africa, and accessing finance. We began to issue security-enhanced national identification cards in July 2013. This project will aid in the establishment of a credit rating agency and foster bank lending to the private sector. We will continue our ongoing land titling program and fully implement the 2010 Land Administrations Act.

IV. Program Issues

14. Safeguard assessment. We remain committed to implementing all safeguards recommendations from the 2010 and 2012 assessments. Specifically, the CBL will continue the practice of appointing international audit firms with experience in auditing central banks for the duration of this and any successor arrangements, and thereafter for as long as IMF's credit remains outstanding. We will also continue to publish the CBL's audited annual financial statements within one month after audit completion. Finally, we allocated sufficient resources in the 2013 budget of the CBL to strengthen internal audit capacity in the near term.

Table 1. Lesotho: Quantitative Performance Criteria, Benchmarks, and Indicative Targets, March 2011–March 2013

	2011						2012						2013			2014	
	March		Status	Sep.		Status	March		Status	Sep.		Status	Mar.		Sep.	2014	
	PC	Act.		PC	Act.		PC	Act.		PC	Act.		PC	Act.			Proj.	Proj.
Ceiling on the domestic financing requirement of the central government ^{1,2}	1,453			1,435			1,629			227			-966			-586	-1,172
<i>Adjusted benchmark</i>	1,670	1,231	Met	1,385	482	Met	1,564	1,284	Met	346	-950	Met	-953	-2,085	Met		
Ceiling on the net domestic assets of the Central Bank of Lesotho ^{1,2}	1,335			1,314			1,275			118			-499			-1,075	-1,809
<i>Adjusted benchmark</i>	1,551	1,397	Met	1,264	9	Met	1,210	515	Met	237	-1,065	Met	-486	-1,796	Met		
	(US\$ millions)																
Floor on the stock of net international reserves of the Central Bank of Lesotho ²	805			634			736			723			987			1,157	1,220
<i>Adjusted benchmark</i>	776	897	Met	641	892	Met	745	851	Met	707	973	Met	985	1,096	Met		
Ceiling on the stock of external payments arrears ³	0	0	Met	0	0	Met	0	0	Met	0	0	Met	0	0		0	0
Ceiling on the amount of new non-concessional external debt contracted or guaranteed by the public sector (cumulative from end-March 2010) ^{2,3}																	
Maturity of less than one year	0	0	Met	0	0	Met	0	0	Met	0	0	Met	0	0	Met	0	0
Maturity of one year or more	182	242	Not Met ⁵	182	242	Not Met ⁵	182	274	Not Met ⁵	182	274	Not Met	274	274	Met	274	274
	(Maloti millions)																
<i>Indicative targets:</i>																	
Floor on the central government social expenditures ⁴	170	205	Met	170	170	Met	170	170	Met	183	147	Not Met	183	195	Met	216	216
<i>Memorandum items:</i>																	
Net disbursements ^{1,2}	304	272	...	-18	32	...	-122	-57	...	-65	-185	...	-104	-118	...	-102	-201
General budget support	552	530	...	154	162	...	207	302	...	120	0	...	300	196	...	162	323
Debt service payments	249	258	...	172	131	...	329	359	...	185	185	...	404	314	...	263	524
SACU receipts ¹	2,628	2,628	...	1,376	1,376	...	2,752	2,752	...	2,983	2,983	...	5,966	5,966	...	3,027	6,055

Sources: Ministry of Finance; Central Bank of Lesotho; and Fund staff estimates.

¹ Values are cumulative from April 1st (beginning of the fiscal year).

² Definitions and program adjusters are specified in the TMU.

³ Continuous performance criteria.

⁴ Includes spending on school feeding program, old age pension, war veterans, and HIV/AIDS.

⁵ At the time of the 4th review under the ECF arrangement for Lesotho on November 27, 2012 the Board granted a waiver of nonobservance of the continuous PC on contracting/guaranteeing of new nonconcessional debt up to 274 million cumulative from March-2010.

Table 2. Structural Benchmarks through May 2013

Benchmarks	Test date	Status
I. Public Financial Management		
Establish a Cash Management Unit in the Treasury.	End-May 2013	Met with delay. Established in late-July 2013.
Reconcile all Treasury (Revenue and Expenditure) Accounts on a monthly basis and produce a monthly monitoring report.	End-May 2013	Not met. Steps are being taken to enforce reconciliation reporting by line ministries.
II. Debt Management		
Submit to Parliament the amendments of the Loans and Guarantees Act	End-May 2013	Not met. The Public Debt Management bill has been sent to the attorney general and will be submitted to the parliament by end-September.



KINGDOM OF LESOTHO

SIXTH REVIEW UNDER THE THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—DEBT SUSTAINABILITY ANALYSIS

August 20, 2013

Approved By
**Anne-Marie Gulde-
Wolf and Chris Lane
(IMF) Marcelo Giugale
and Jeffrey Lewis
(World Bank)**

Prepared by staffs of the International Monetary Fund and
the World Bank

Lesotho remains at moderate risk of debt distress. Though, in the near term, new nonconcessional loans to finance some key infrastructure projects are expected to temporarily raise debt ratios, most debt sustainability indicators are below the indicative thresholds. As a small open economy, Lesotho is vulnerable to adverse global or regional shocks. The risks appear manageable over the medium-term if the authorities are able to continue with fiscal adjustment in the coming years, while maintaining a sufficient international reserve buffer to protect the exchange rate peg. The results of this analysis underscore the critical need to realign spending with its sustainable level consistent with the expected long-run level of SACU revenue, while moving forward with structural reforms to boost productivity and competitiveness to accelerate medium-term growth.

INTRODUCTION

1. This DSA has been prepared jointly by IMF and World Bank staffs. It comprises external and domestic debt, and is based on the framework for low-income countries approved by the respective Executive Boards.¹ The framework takes into account indicative thresholds for debt burden indicators determined by the quality of the country's policies and institutions,² and comprises baseline and alternative scenarios. Given the importance of remittances in enhancing Lesotho's capacity to repay debt, the DSA also uses the remittance-modified debt indicators, in addition to a standard baseline scenario, to assess the risk of debt distress.^{3,4}

RECENT DEBT DEVELOPMENTS

2. Lesotho's public sector debt (in terms of GDP) rose moderately, and the concessionality portion declined since the 2012 DSA. Public sector debt rose from 36¾ percent of GDP in 2011/12 to 38 percent at end-2012/13, largely owing to substantial depreciation of the loti/dollar exchange rate in 2012–2013 (by 34 percent in two years). Without the depreciation, the ratio would have declined to 28.2 percent. During the same period, the proportion of nonconcessional debt in total debt declined from 82.4 percent, to 78 percent, as the authorities repaid export credit and commercial borrowing. All categories of debt increased, and of the total public sector debt, US\$758 million was owed to external creditors, with most to multilaterals (US\$676 million).

¹ See "Applying the Debt Sustainability Framework for Low-Income Countries Post Debt Relief," (IDA/SecM2006-0564 and <http://www.imf.org/external/np/pp/eng/2006/110606.pdf> and "Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework for Low-Income Countries" <http://www.imf.org/external/np/pp/eng/2010/012210.pdf>.

² The World Bank Country Policy and Institutional Assessment has ranked Lesotho using the three-year moving average as a "medium performer" in terms of policy and institutions with a rating of 3.4. The applicable indicative thresholds for debt sustainability, proposed under the framework for low-income countries are: (i) 40 percent for the NPV of debt-to-GDP ratio, (ii) 150 percent for NPV of debt-to-exports ratio; (iii) 250 percent for the NPV of debt-to-fiscal revenues ratio; (iv) 20 percent for the debt service to exports ratio; and (v) 20 percent for the debt service to revenue ratio.

³ The definition of remittances was revised in the last DSA, based on a more detailed BOP framework compared to the one that was used for the previous May 2010. The revision resulted in lower values both for past years and the projections.

⁴ See "Applying the Debt Sustainability Framework for Low-Income Countries Post Debt Relief," (IDA/SecM2006-0564 and SM/07/131) and "Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework for Low-Income Countries," <http://www.imf.org/external/np/pp/eng/2010/012210.pdf>. The past two DSAs have used remittance-modified debt indicators.

Lesotho: Public Debt Outstanding at end-2012/13

	in Millions of maloti	in Millions of USD	in Percent of GDP
Total public debt	7,849	863	38.0
Domestic debt	952	105	4.6
External debt	6,898	758	33.4
Multilateral	6,151	676	29.8
IDA	2,745	302	13.3
African Development Fund	1,849	203	9.0
IMF	494	54	2.4
Others	1,063	117	5.2
Export credit	378	42	1.8
Bilateral	300	33	1.5
Commercial	69	8	0.3

Source: Ministry of Finance.

3. The level of debt (in U.S. dollars) increased in 2012/13, largely owing to increased financing for key infrastructure projects (e.g., Metolong Dam) and financial supports from the IMF under the ECF arrangement. The total loans of about US\$70 million from Lesotho's international partners were disbursed for the Metolong Dam project, which is expected to be completed by 2014/15. During 2012/13, in view of Lesotho's strong implementation of its economic program, three reviews under the ECF arrangements were successfully completed.

4. Public domestic debt (held by residents) is only a small proportion of total public debt. At end-2012/13, it comprised mainly treasury bills and treasury bonds, and amounted to US\$105 million, about 4.6 percent of GDP. The government relies on domestic debt mainly for financing the budget deficit. Domestic debt increased by 0.3 percent in the period under review, mainly as a result of the issuance of treasury bonds meant to facilitate capital market development and provide the government with an alternative source of funds. Short-term debt constituted 54 percent of total domestic debt while long-term debt amounted to 46 percent. The banking system is the main holder of domestic debt instruments, amounting to about 90 percent of currently outstanding debt.

5. Fiscal balances improved significantly in 2012/13, and the government began to accumulate deposits. For the first time since 2008/09, the government recorded a fiscal surplus (estimated at 5.2 percent of GDP), primarily owing to a sizable improvement in Southern African Customs Union (SACU) revenue and the fiscal consolidation efforts. Having run a fiscal deficit since 2009/10, the government had drawn on deposits at the CBL (reducing the deposit of 5.8 billion maloti in July 2009 to 2.8 billion maloti in March 2012). The government deposits have since been partly recovered, reaching 4.8 billion maloti by March 2013. To achieve the authorities' medium-term international reserve target of five months of imports, further accumulation of deposits, at a slower pace, is expected in coming years on the basis of the implementation of the planned fiscal adjustment, bringing down the need for new debt.

6. The authorities have stepped up their efforts to strengthen debt management, through (i) resuscitating the Public Debt Management Committee; (ii) preparing a medium-term debt management strategy (MTDS); and (iii) preparing a new Public Debt Management Bill. Based on the Debt Management Performance Assessment undertaken by the World Bank in late 2012, the authorities have been preparing an MTDS, with assistance of the World Bank. The authorities, in collaboration with the IMF, have been working on a Public Debt Management Bill, which will consolidate and address weaknesses in the existing legal framework for public debt management. The Public Debt Management Committee, which is now charged with reviewing and recommending loans to the minister, has been fully operational since late 2012.

7. The authorities are cognizant of the need to improve the productivity of investment and have recently embarked on strategic planning as well as PFM reforms. Guided by the objectives of the National Strategic Development Plan, the Public Sector Investment Programme has recently been finalized, providing a five-year program of ongoing and new investment projects. As part of the PFM reforms, there are plans to strengthen the medium-term expenditure framework (MTEF) and enforce rigorous assessments of all public investment by the Project Appraisal Committee (PAC). To focus on priority projects with high economic rates of return and consistent with Lesotho's debt service capacity to avoid debt distress, new capital projects are appraised by the PAC before being allocated in the budget and incorporated into the MTEF.

BASELINE MACROECONOMIC ASSUMPTIONS

8. The results of this debt sustainability analysis are based on a number of important assumptions, notably sustained economic growth over the medium term; continuous fiscal consolidation; and a relatively favorable external environment.

Macroeconomic Assumptions, 2012-2033									
	2012	2013	2014	2015	2016	2017	2018	2019-2033	
	Actual	Estimate	Projections						Average
Real GDP Growth (percent)	4.3	4.0	5.3	4.5	4.1	5.0	5.4	4.8	
GDP deflator in U.S. dollar terms (change, in percent)	-8.3	-0.5	4.3	3.8	1.1	1.8	5.3	2.2	
Effective interest rate (percent)	0.5	0.7	1.2	1.3	1.4	1.5	1.6	1.6	
Growth of exports of goods and services (U.S. dollar terms, percent)	-7.7	2.5	18.5	10.1	4.7	5.6	8.1	8.6	
Growth of imports of goods and services (U.S. dollar terms, percent)	-2.6	0.5	1.4	1.6	2.3	4.9	1.5	7.3	
Grant element of new public sector borrowing (percent)	...	27.8	30.0	32.2	24.7	15.6	11.6	20.0	
Government revenue (excluding grants, percent of GDP)	55.8	54.3	50.7	47.8	47.1	46.7	46.3	46.3	
Aid flows (millions of U.S. dollars)	825.4	852.1	761.2	756.0	747.9	729.1	698.3	495.6	
<i>of which:</i>									
<i>Grants</i>	200.5	180.2	61.1	60.5	69.9	73.4	70.5	127.5	
<i>Concessional loans</i>	624.9	671.9	700.1	695.5	678.0	655.7	627.8	368.1	
Grant equivalent financing (percent of GDP)	...	7.6	2.6	2.3	2.7	2.6	2.3	2.4	
Grant equivalent financing (percent of external financing)	...	86.7	73.5	80.2	65.4	55.0	43.7	50.2	

- **Real GDP growth** reached 4.3 percent in 2012/13 and is projected to increase in coming years, driven by the recovery in agricultural production and continued expansion of mining. Between 2018/19 and 2032/33, annual growth is projected to average 4.8 percent, driven by productivity improvements from ongoing structural reforms, including business climate reforms under the National Strategic Development Plan and the construction of the Lesotho Highlands Water Project, Phase II (LHWP II), which are likely to make Lesotho an exporter of water and electricity in the region.

- **Inflation** is assumed to move from an average of 6.2 percent in the last ten years to 6.1 percent between 2013/14 and 2017/18, reflecting an expected recovery in prices of major export items and projected consumer price inflation in South Africa. In the longer term, inflation is projected to average 5 percent.
- **Fiscal balances** are assumed to remain in surplus over the medium term, on the basis of the implementation of the planned fiscal adjustment to maintain sufficient international reserve buffer. Key elements of the fiscal assumptions are phasing in a reduction in recurrent spending, in terms of GDP over the medium term, while safeguarding social spending for poor and vulnerable groups; further strengthening of public expenditure and financial management; and strengthening revenue administration. SACU revenue is projected at 25 percent of GDP in 2013/14, before stabilizing at about 17–20 percent of GDP in the medium term. Following the fiscal surplus of 5.2 percent of GDP in 2012/13, a surplus of 2–4 percent of GDP is expected over the medium term. In the longer term, this DSA assumes zero net domestic borrowing (constant rollover of existing debt, as the government envisages a fiscal balance in the medium to long term) and net external borrowing of about 1 percent of GDP a year (excluding borrowing for the hydropower project of LHWP II, amounting to about 3–4 percent of GDP annually between 2017/18 and 2021/22). Borrowing associated with the LHWP II is not assumed to be on concessional terms.
- **The current account deficit** is estimated to remain high (above 11 percent of GDP) through 2017/18, owing to strong import demand associated with projects for energy and water developments. The deficit is projected to gradually declining to 1 percent of GDP over the long term. International reserves are projected to reach five months of imports by 2016/17 and stay at or above that level over the long term.

EXTERNAL DEBT SUSTAINABILITY

A. Baseline

9. **Lesotho's present value (PV) of external debt (41.5 percent of GDP at end-2012/13) is projected to decline to 30 percent by 2018/19 before increasing to 37 by 2020/21** (Table 1a). This temporary increase is driven predominantly by nonconcessional borrowing for the Metolong dam and the LHWP II. The PV of external debt is thus projected to remain below the 40 percent indicative threshold, and to decline thereafter to 21½ percent by 2033/34. The significant decline in the PV of external debt after 2021/22 is driven partly by the large swing in the grant element of external debt after the amortization of project loans for the Metolong dam and the LHWP II (which is assumed to be on commercial terms).⁵

⁵ Borrowing associated with the LHWP II is assumed to be on market terms, resulting in a decline in the overall grant element of borrowing between 2013 and 2019. Except for the loans for the LHWP II, it is assumed that Lesotho continues to receive concessional loans (no permanent shift in grant element is envisaged), not only because the authorities continue to seek concessional financing but also because
(continued)

10. The PV of external debt relative to exports and to revenue would also rise through 2020/21, but remain well below the respective indicative thresholds of 150 and 250 percent. The ratio of debt service to exports is expected to remain stable, averaging around 2.7 percent of GDP in the medium term, and rising to an average of 4.2 percent in 2020/21–2033/34. The ratio of debt service to revenue maintains a similar trend. Both ratios would remain well below the thresholds because of the highly concessional nature of existing debt. The gradual increase in the ratios of debt service is due to the assumed changes in international interest rates. The rates are projected to average 1.4 percent in the medium term, while increasing to an average of around 1¾ percent in the longer term. Taking into account remittances, the PV of external debt (in percent of GDP and remittances) would be slightly lower than the ratio without remittances.

B. Sensitivity tests

11. Sensitivity tests show that Lesotho’s debt burden would increase in the event of less favorable public sector borrowing terms (Table 1b). In a scenario in which the interest rate on new public sector loans is 2 percentage points higher than the baseline assumption (scenario A2), the PV of debt-to-GDP ratio reaches 38 percent in 2022/23 and falls to 31 percent by 2033/34. In a scenario in which the key variables are set at their average of the past 10 years, Lesotho’s debt ratios actually fall relative to the baseline, reflecting strong inflows of non-debt-creating FDI, and the high level of average fiscal surplus over this period owing to the sizable SACU revenue in 2006/07–2008/09. However, given the structural break, the historical scenario could be considered less relevant for the analysis.

12. Bound tests reveal that Lesotho would face the most distress in nominal exchange rate depreciation or if export growth turned out lower than the historical average. In a scenario where export value grows (B2) at one standard deviation lower than the historical average, the PV of debt-to-GDP ratio would increase to 44 percent by 2014/15 and then ease to 23 percent in 2033/34. In the event of a one-time 30 percent depreciation of the nominal exchange rate (B6) in 2014, the PV of debt-to-GDP ratio would similarly increase to 43 percent by 2014/15, but then fall to 30 percent by 2033/34. The indicative threshold of 40 percent would also temporarily be breached if the U.S. dollar GDP deflator or export value growth turned out lower than the historical average. The same holds for a combined shock including lower GDP growth and lower non-debt-creating flows (such as FDI) compared to the historical average. While a temporary adverse shock to non-debt creating flows could lead to only a temporary breach of the indicative threshold, a permanent adverse shock to SACU revenues could increase public debt further. The revenues, however, are assumed to be relatively modest, compared with their historical average (27 percent of GDP for the last ten years).

there are very few projects that would attract commercial financing. Thus once the project is fully financed in 2021, new loans will likely follow past patterns in terms of concessionality. According to preliminary project documents, the total cost of the LHWP II project is estimated at M16.8 billion, or 81 percent of GDP, with a water transfer component (M9.2 billion) funded by South Africa and a hydro-power station (M7.6 billion) to be funded by the government of Lesotho through external borrowing in 2017–2021.

PUBLIC SECTOR DEBT SUSTAINABILITY

13. Public debt indicators largely mirror those of external debt, because domestic debt remains relatively low (4.6 percent of GDP at the end of 2012/13). Domestic debt is projected to fall to 2¾ percent of GDP by 2016/17, and then to gradually fall to 1 percent of GDP in 2031/32. This fall reflects the assumption of zero net domestic borrowing after 2016/17. The PV of public sector debt stood at 42.7 percent in 2012/13.

14. The standard sensitivity tests—including the scenarios with (i) an unchanged primary balance from 2012/13 and (ii) lower long-run GDP growth—do not reveal any substantial deviation of the baseline scenario, with the debt indicators below the threshold. As highlighted in the stress tests for external debt, bound tests reveal that Lesotho would face most distress in nominal exchange rate depreciation or if export growth turned out lower than the historical average.

CONCLUSION

15. Lesotho remains at moderate risk of debt distress. The PV of external debt as a ratio of GDP is projected to remain below the indicative threshold of 40 percent in the baseline scenario. The ratio is projected to decline thereafter because the fiscal balance is broadly maintained over the projection period. By the end of the projection period in 2033/34, the ratio also lies below the indicative threshold for debt distress. However, the risk of debt distress is magnified as stress tests result in a temporary breach of indicative thresholds. It increases significantly in the event of adverse shocks to exports or significant exchange rate depreciation. The risks appear manageable over the medium term if the authorities are able to move forward with the planned fiscal adjustment in coming years. The results of this analysis underscore the critical need to maintain the current fiscal adjustment efforts, while keeping fiscal space for key infrastructure projects and social spending and moving forward with structural reforms to boost productivity and competitiveness to accelerate medium-term growth. Finally, remittance enhanced analysis provides more positive outcomes, because none of the thresholds was breached. This indicates the strong influence of remittance flows in overall debt sustainability.

16. The authorities broadly agreed with the assessment of moderate risk of debt distress. The authorities appreciated that the PV of external debt ratio comes close to breaching the indicative threshold temporarily in 2020/21, partly owing to the construction of the Metolong dam and the electricity pump storage under the LHWP II. They agreed that the risk of debt distress increases significantly with adverse shocks and with the need to maintain the current fiscal consolidation efforts, while keeping a fiscal space for key infrastructure projects and social spending and moving forward with structural reforms to boost productivity and competitiveness to accelerate medium-term growth.

Table 1a. External Debt Sustainability Framework, Baseline Scenario, 2010-2033

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average	Standard Deviation	Projections											2019-2033 Average	
	2010	2011	2012			2013	2014	2015	2016	2017	2018	2013-2018 Average		2019	2020	2021		2022	2023	2033
External debt (nominal) ¹	29.7	30.5	33.4			33.5	32.6	31.4	31.3	31.3	30.9		35.3	38.9	39.1	37.5	36.0	25.6
o/w public and publicly guaranteed (PPG)	29.7	30.5	33.4			33.5	32.6	31.4	31.3	31.3	30.9		35.3	38.9	39.1	37.5	36.0	25.6
Change in external debt	...	0.8	2.9			0.1	-0.9	-1.2	-0.1	0.0	-0.4		4.4	3.6	0.2	-1.6	-1.5	-0.7
Identified net debt-creating flows	...	...	3.5			2.7	1.2	2.9	3.3	3.7	-3.0		4.2	5.4	0.7	-0.7	-1.2	-6.3
Non-interest current account deficit	14.2	23.8	10.2	0.7	12.3	14.3	12.6	11.5	11.1	11.0	4.0		11.2	12.4	7.8	6.5	5.9	0.5
Deficit in balance of goods and services	67.2	63.4	67.0			64.3	52.8	45.8	43.5	42.4	36.1		42.3	43.0	37.6	35.6	34.4	26.8
Exports	42.5	44.6	43.0			42.6	46.0	46.6	46.4	45.8	44.7		45.2	45.8	46.6	49.3	50.1	55.3
Imports	109.6	108.0	110.0			106.9	98.7	92.5	89.9	88.2	80.7		87.5	88.8	84.3	84.9	84.6	82.1
Net current transfers (negative = inflow)	-28.9	-26.8	-39.6	-38.4	7.1	-35.7	-29.6	-26.5	-25.5	-25.4	-24.9		-25.0	-25.0	-25.0	-25.0	-25.0	-24.9
o/w official	-21.6	-19.9	-32.9			-29.4	-23.6	-20.7	-19.7	-19.8	-19.5		-19.6	-19.6	-19.6	-19.6	-19.6	-19.6
Other current account flows (negative = net inflow)	-24.1	-12.8	-17.2			-14.3	-10.5	-7.9	-6.9	-6.0	-7.2		-6.1	-5.6	-4.9	-4.2	-3.6	-1.3
Net FDI (negative = inflow)	-5.2	-5.4	-8.2	-5.7	1.2	-10.5	-10.2	-7.6	-7.0	-6.3	-6.0		-6.0	-6.0	-6.0	-6.0	-6.0	-6.0
Endogenous debt dynamics ²	...	...	1.5			-1.1	-1.2	-1.0	-0.8	-1.0	-1.0		-0.9	-1.0	-1.1	-1.1	-1.1	-0.8
Contribution from nominal interest rate	...	...	0.1			0.2	0.4	0.4	0.4	0.5	0.5		0.5	0.6	0.6	0.6	0.6	0.4
Contribution from real GDP growth	0.0	0.0	-1.4			-1.3	-1.6	-1.4	-1.2	-1.5	-1.5		-1.4	-1.6	-1.7	-1.8	-1.7	-1.2
Contribution from price and exchange rate changes	0.0	0.0	2.8			...	...	...	...	...	...		...	...	...	...	...	...
Residual (3-4) ³	...	...	-0.6			-2.6	-2.1	-4.1	-3.5	-3.7	2.6		0.1	-1.8	-0.5	-0.9	-0.3	5.5
o/w exceptional financing	...	...	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.0	0.0	0.0
PV of external debt ⁴	...	...	41.5			38.7	35.4	33.0	31.7	31.2	29.8		33.5	36.9	36.0	33.0	30.8	21.5
In percent of exports	...	...	96.4			90.8	77.0	70.7	68.4	68.1	66.8		74.1	80.6	77.2	67.0	61.4	38.9
PV of PPG external debt	...	...	41.5			38.7	35.4	33.0	31.7	31.2	29.8		33.5	36.9	36.0	33.0	30.8	21.5
In percent of exports	...	...	96.4			90.8	77.0	70.7	68.4	68.1	66.8		74.1	80.6	77.2	67.0	61.4	38.9
In percent of government revenues	...	...	74.3			71.2	69.9	69.0	67.4	66.7	64.5		72.4	79.8	77.6	71.3	66.4	46.5
Debt service-to-exports ratio (in percent)	3.8	3.3	2.9			3.4	3.0	2.8	2.5	2.4	2.3		3.7	4.0	4.2	4.1	4.1	4.9
PPG debt service-to-exports ratio (in percent)	3.8	3.3	2.9			3.4	3.0	2.8	2.5	2.4	2.3		3.7	4.0	4.2	4.1	4.1	4.9
PPG debt service-to-revenue ratio (in percent)	3.6	3.4	2.3			2.7	2.7	2.7	2.4	2.3	2.2		3.7	4.0	4.3	4.4	4.5	5.8
Total gross financing need (Billions of U.S. dollars)	245.8	504.5	78.7			131.9	103.6	152.8	165.9	194.4	-36.1		273.9	350.9	170.8	122.0	102.5	-292.2
Non-interest current account deficit that stabilizes debt ratio	14.2	-6.7	7.3			14.2	13.5	12.7	11.2	10.9	4.4		6.8	8.8	7.6	8.1	7.4	1.3
Key macroeconomic assumptions																		
Real GDP growth (in percent)	6.8	5.4	4.3	4.5	1.2	4.0	5.3	4.5	4.1	5.0	5.4	4.7	5.0	4.8	4.8	4.8	4.8	4.8
GDP deflator in US dollar terms (change in percent)	13.6	3.8	-8.3	10.1	17.9	-0.5	4.3	3.8	1.1	1.8	5.3	2.6	2.0	2.2	2.2	2.2	2.2	2.2
Effective interest rate (percent) ⁵	...	...	0.5	0.5	...	0.7	1.3	1.4	1.5	1.6	1.7	1.4	1.7	1.8	1.8	1.7	1.7	1.6
Growth of exports of G&S (US dollar terms, in percent)	21.1	14.8	-7.7	10.1	15.2	2.5	18.5	10.1	4.7	5.6	8.1	8.2	8.4	8.5	8.9	13.2	8.9	8.3
Growth of imports of G&S (US dollar terms, in percent)	16.5	7.8	-2.6	11.5	15.1	0.5	1.4	1.6	2.3	4.9	1.5	2.0	16.1	8.6	1.6	7.9	6.7	6.9
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	28.1	33.1	32.2	24.7	15.6	9.6	23.9	-7.9	-1.3	10.0	24.7	24.7	19.8
Government revenues (excluding grants, in percent of GDP)	44.1	43.3	55.8			54.3	50.7	47.8	47.1	46.7	46.3	48.8	46.3	46.3	46.3	46.3	46.3	46.3
Aid flows (in Billions of US dollars) ⁷	800.3	823.2	825.4			852.1	761.2	756.0	747.9	729.1	698.3		670.6	639.2	608.5	578.6	551.4	368.7
o/w Grants	166.8	192.9	200.5			180.2	61.1	60.5	69.9	73.4	70.5		75.5	80.9	86.7	92.8	99.4	197.4
o/w Concessional loans	633.5	630.3	624.9			671.9	700.1	695.5	678.0	655.7	627.8		595.1	558.3	521.8	485.8	452.0	171.3
Grant-equivalent financing (in percent of GDP) ⁸	...	...	...			7.6	2.5	2.3	2.5	2.6	2.2		1.4	1.8	2.4	2.8	2.9	2.4
Grant-equivalent financing (in percent of external financing) ⁸	...	...	...			87.8	81.6	80.2	72.8	55.0	45.5		16.2	19.1	35.4	50.1	48.1	61.4
Memorandum items:																		
Nominal GDP (Billions of US dollars)	2,319	2,536	2,426			2,510	2,757	2,990	3,148	3,363	3,731		3,996	4,280	4,584	4,909	5,258	10,440
Nominal dollar GDP growth	21.3	9.4	-4.4			3.5	9.8	8.5	5.3	6.9	10.9	7.5	7.1	7.1	7.1	7.1	7.1	7.1
PV of PPG external debt (in Billions of US dollars)	...	...	940			971	976	986	998	1,049	1,114	1,015	1,340	1,581	1,648	1,620	1,617	2,246
(PVt-PVt-1)/GDPT-1 (in percent)	...	...	...			1.3	0.2	0.4	0.4	1.6	1.9	1.0	6.1	6.0	1.6	-0.6	-0.1	0.9
Gross workers' remittances (Billions of US dollars)	365.0	309.6	267.5			242.8	225.3	220.2	219.2	215.0	212.7		194.1	39.8	38.0	17.7	-2.3	-272.0
PV of PPG external debt (in percent of GDP + remittances)	...	...	37.3			35.3	32.7	30.7	29.6	29.3	28.2		32.0	36.6	35.7	32.9	30.8	22.1
PV of PPG external debt (in percent of exports + remittances)	...	...	76.7			74.0	65.4	61.0	59.4	59.7	59.3		67.0	79.0	75.8	66.5	61.4	40.8
Debt service of PPG external debt (in percent of exports + remittances)	...	...	2.3			2.8	2.5	2.4	2.1	2.1	2.0		3.4	3.9	4.2	4.1	4.1	5.1

Sources: Lesotho authorities; and IMF staff estimates and projections.

¹ Includes both public and private sector external debt.² Derived as $[r - g - p(1+g)] / (1+g+p+gp)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and p = growth rate of GDP deflator in U.S. dollar terms.³ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.⁴ Assumes that PV of private sector debt is equivalent to its face value.⁵ Current-year interest payments divided by previous period debt stock.⁶ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.⁷ Defined as grants, concessional loans, and debt relief.⁸ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 1b. Lesotho: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013–2033

	Projections							
	2013	2014	2015	2016	2017	2018	2023	2033
(In percent)								
PV of debt-to GDP ratio								
Baseline	39	35	33	32	31	30	31	22
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 ¹	39	29	20	11	4	4	-10	4
A2. New public sector loans on less favorable terms in 2013-2033 ²	39	36	33	32	32	32	38	31
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	39	36	34	33	32	31	32	22
B2. Export value growth at historical average minus one standard deviation in 2014-2015 ³	39	43	53	51	50	47	44	23
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	39	40	42	40	40	38	39	27
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 ⁴	39	41	38	37	36	35	34	22
B5. Combination of B1-B4 using one-half standard deviation shocks	39	46	52	50	49	46	44	25
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 ⁵	39	50	46	45	44	42	43	30
PV of debt-to-exports ratio								
Baseline	91	77	71	68	68	67	61	39
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 ¹	91	63	42	24	9	9	-20	8
A2. New public sector loans on less favorable terms in 2013-2033 ²	91	78	72	70	71	71	76	57
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	91	77	71	68	68	67	61	39
B2. Export value growth at historical average minus one standard deviation in 2014-2015 ³	91	118	165	160	158	153	129	61
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	91	77	71	68	68	67	61	39
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 ⁴	91	89	82	80	79	77	68	40
B5. Combination of B1-B4 using one-half standard deviation shocks	91	110	128	124	123	119	101	51
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 ⁵	91	77	71	68	68	67	61	39
PV of debt-to-revenue ratio								
Baseline	71	70	69	67	67	64	66	46
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 ¹	71	58	41	24	9	9	-21	9
A2. New public sector loans on less favorable terms in 2013-2033 ²	71	70	70	69	69	68	83	68
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	71	71	71	69	69	66	68	48
B2. Export value growth at historical average minus one standard deviation in 2014-2015 ³	71	86	111	109	107	102	96	50
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	71	79	88	86	85	82	85	59
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 ⁴	71	80	80	79	78	75	74	47
B5. Combination of B1-B4 using one-half standard deviation shocks	71	91	108	106	105	100	95	53
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 ⁵	71	98	97	95	94	90	93	65
Debt service-to-exports ratio								
Baseline	3	3	3	2	2	2	4	5
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 ¹	3	2	2	1	2	1	3	-1
A2. New public sector loans on less favorable terms in 2013-2033 ²	3	2	2	2	3	3	7	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	3	2	2	2	3	3	8	2
B2. Export value growth at historical average minus one standard deviation in 2014-2015 ³	3	3	3	4	6	5	14	5
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	3	2	2	2	3	3	8	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 ⁴	3	2	2	2	4	3	9	3
B5. Combination of B1-B4 using one-half standard deviation shocks	3	2	3	3	5	4	12	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 ⁵	3	2	2	2	3	3	8	2
Debt service-to-revenue ratio								
Baseline	3	3	3	2	2	2	4	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 ¹	3	2	2	1	2	1	3	-1
A2. New public sector loans on less favorable terms in 2013-2033 ²	3	2	2	2	3	3	8	4
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	3	2	2	2	3	3	9	3
B2. Export value growth at historical average minus one standard deviation in 2014-2015 ³	3	2	2	3	4	3	10	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	3	2	3	3	4	3	11	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 ⁴	3	2	2	2	4	3	10	3
B5. Combination of B1-B4 using one-half standard deviation shocks	3	2	3	3	4	3	11	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 ⁵	3	3	3	3	5	4	13	4
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) ⁶	13	13	13	13	13	13	13	13

Sources: Lesotho authorities; and IMF staff estimates and projections.

¹ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

² Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.

³ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

⁴ Includes official and private transfers and FDI.

⁵ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

⁶ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 2a. Lesotho: Public Sector Debt Sustainability Framework, Baseline Scenario, 2010–2033

(In percent of GDP, unless otherwise indicated)

	Actual			Average ⁵	Standard Deviation ⁵	Estimate					Projections			
	2010	2011	2012			2013	2014	2015	2016	2017	2018	2013-18 Average	2023	2033	2019-33 Average
Public sector debt¹	34.4	36.7	38.0			37.5	36.1	34.4	34.0	33.7	33.0		37.3	26.1
o/w foreign-currency denominated	29.7	30.5	33.4			33.5	32.6	31.4	31.3	31.3	30.9		36.0	25.6
Change in public sector debt	4.7	2.2	1.4			-0.5	-1.4	-1.6	-0.5	-0.3	-0.7		-1.6	-0.8
Identified debt-creating flows	...	...	-3.3			-6.2	-6.0	-7.0	-5.9	-6.5	-8.1		-2.5	-1.7
Primary deficit	4.4	9.5	-6.0	-4.6	8.1	-2.9	-3.1	-4.7	-4.7	-4.8	-5.3	-4.2	-0.6	-0.4
Revenue and grants	51.3	50.9	64.1			61.5	52.9	49.8	49.3	48.9	48.2		48.2	48.2
of which: grants	7.2	7.6	8.3			7.2	2.2	2.0	2.2	2.2	1.9		1.9	1.9
Primary (noninterest) expenditure	55.7	60.4	58.1			58.6	49.8	45.1	44.6	44.1	42.9		47.6	47.8
Automatic debt dynamics	...	...	2.7			-3.3	-2.9	-2.3	-1.2	-1.7	-2.8		-1.9	-1.4
Contribution from interest rate/growth differential	...	...	-1.6			-1.9	-2.0	-1.7	-1.4	-1.7	-1.8		-1.8	-1.3
of which: contribution from average real interest rate	...	...	-0.1			-0.4	-0.1	-0.1	0.0	-0.1	-0.1		-0.1	-0.1
of which: contribution from real GDP growth	0.0	-0.2	-1.5			-1.5	-1.9	-1.6	-1.4	-1.6	-1.7		-1.8	-1.2
Contribution from real exchange rate depreciation	...	...	4.3			-1.5	-0.9	-0.6	0.1	0.1	-0.9		...	...
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Residual, including asset changes	...	...	4.7			5.7	4.6	5.4	5.4	6.2	7.4		0.9	0.9
Other Sustainability Indicators														
PV of public sector debt	...	...	46.1			42.7	38.8	36.0	34.4	33.6	32.0		32.0	22.0
o/w foreign-currency denominated	...	...	41.5			38.7	35.4	33.0	31.7	31.2	29.8		30.8	21.5
o/w external	...	...	41.5			38.7	35.4	33.0	31.7	31.2	29.8		30.8	21.5
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...
Gross financing need ²	...	12.1	-3.6			-0.2	-0.9	-2.7	-2.9	-3.1	-3.7		1.7	2.5
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	71.9			69.4	73.4	72.3	69.8	68.7	66.3		66.5	45.6
PV of public sector debt-to-revenue ratio (in percent)	...	...	82.5			78.6	76.7	75.3	73.1	71.9	69.0		69.2	47.5
o/w external ³	...	...	74.3			71.2	69.9	69.0	67.4	66.7	64.5		66.4	46.5
Debt service-to-revenue and grants ratio (in percent) ⁴	...	5.1	3.8			4.3	4.2	4.1	3.6	3.5	3.5		4.8	5.9
Debt service-to-revenue ratio (in percent) ⁴	...	5.9	4.3			4.9	4.4	4.2	3.7	3.7	3.6		5.0	6.2
Primary deficit that stabilizes the debt-to-GDP ratio	-0.4	7.3	-7.4			-2.3	-1.7	-3.0	-4.2	-4.6	-4.6		1.0	0.4
Key macroeconomic and fiscal assumptions														
Real GDP growth (in percent)	6.8	5.4	4.3	4.5	1.2	4.0	5.3	4.5	4.1	5.0	5.4	4.7	4.8	4.8
Average nominal interest rate on forex debt (in percent)	...	...	0.5	0.5	...	0.7	1.3	1.4	1.5	1.6	1.7	1.4	1.7	1.6
Average real interest rate on domestic debt (in percent)	...	0.3	2.6	1.4	1.7	-3.0	-1.6	-1.1	1.1	0.7	-0.6	-0.8	2.7	2.7
Real exchange rate depreciation (in percent, + indicates depreciation)	-10.4	7.4	14.7	-1.9	13.4	-4.6	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	4.6	7.5	4.7	6.6	2.9	11.4	9.8	9.2	6.9	7.2	8.6	8.8	5.2	5.2
Growth of real primary spending (deflated by GDP deflator, in percent)	-0.1	0.1	0.0	0.1	0.1	0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	...	...	28.1	33.1	32.2	24.7	15.6	9.6	23.9	24.7	24.7

Sources: Lesotho authorities; and IMF staff estimates and projections.

¹ Gross debt is used. The public sector comprises the central government, the Central Bank of Lesotho and all enterprises with majority state ownership.² Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.³ Revenue excluding grants.⁴ Debt service is defined as the sum of interest and amortization of medium and long-term debt.⁵ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2b.Lesotho: Sensitivity Analysis for Key Indicators of Public Debt 2013–2033

	Projections							
	2013	2014	2015	2016	2017	2018	2023	2033
PV of Debt-to-GDP Ratio								
Baseline	43	39	36	34	34	32	32	22
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	43	38	35	34	33	32	16	-18
A2. Primary balance is unchanged from 2013	43	39	38	38	38	39	28	1
A3. Permanently lower GDP growth ¹	43	39	37	35	35	34	38	40
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-2015	43	41	39	39	39	38	43	39
B2. Primary balance is at historical average minus one standard deviations in 2014-2015	43	45	49	47	45	43	41	27
B3. Combination of B1-B2 using one half standard deviation shocks	43	42	43	42	41	40	42	34
B4. One-time 30 percent real depreciation in 2014	43	55	50	48	46	43	39	29
B5. 10 percent of GDP increase in other debt-creating flows in 2014	43	48	44	42	41	39	38	25
PV of Debt-to-Revenue Ratio ²								
Baseline	69	73	72	70	69	66	66	46
A1. Real GDP growth and primary balance are at historical averages	69	72	71	68	68	67	34	-37
A2. Primary balance is unchanged from 2013	69	74	76	76	78	80	57	3
A3. Permanently lower GDP growth ¹	69	74	73	72	71	70	78	82
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-2015	69	77	79	79	80	79	89	81
B2. Primary balance is at historical average minus one standard deviations in 2014-2015	69	84	97	95	93	89	84	56
B3. Combination of B1-B2 using one half standard deviation shocks	69	79	85	84	84	83	87	71
B4. One-time 30 percent real depreciation in 2014	69	103	101	97	94	89	82	60
B5. 10 percent of GDP increase in other debt-creating flows in 2014	69	90	89	86	84	81	78	52
Debt Service-to-Revenue Ratio ^{2/}								
Baseline	4	4	4	4	4	3	5	6
A1. Real GDP growth and primary balance are at historical averages	4	4	4	3	3	3	4	3
A2. Primary balance is unchanged from 2013	4	4	4	3	3	3	5	4
A3. Permanently lower GDP growth ¹	4	4	4	3	3	3	5	7
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-2015	4	4	4	3	3	3	5	8
B2. Primary balance is at historical average minus one standard deviations in 2014-2015	4	4	4	4	4	3	5	7
B3. Combination of B1-B2 using one half standard deviation shocks	4	4	4	3	3	3	5	7
B4. One-time 30 percent real depreciation in 2014	4	4	5	4	4	4	7	9
B5. 10 percent of GDP increase in other debt-creating flows in 2014	4	4	4	4	3	3	5	7

Sources: Lesotho authorities; and IMF staff estimates and projections.

¹ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

² Revenues are defined inclusive of grants.

Table 3b. Lesotho: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013–2033

	Projections							
	2013	2014	2015	2016	2017	2018	2023	2033
PV of debt-to-GDP+remittances ratio								
Baseline	35	33	31	30	29	28	31	22
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 ¹	35	27	18	11	4	4	-10	4
A2. New public sector loans on less favorable terms in 2013-2033 ²	35	33	31	30	30	30	38	32
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	35	33	32	31	30	29	32	23
B2. Export value growth at historical average minus one standard deviation in 2014-2015 ³	35	40	49	48	47	45	45	24
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	35	37	38	37	37	35	39	28
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 ⁴	35	38	35	35	34	33	34	22
B5. Combination of B1-B4 using one-half standard deviation shocks	35	42	47	46	45	43	44	25
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 ⁵	35	45	42	41	40	39	43	31
PV of debt-to-exports+remittances ratio								
Baseline	74	65	61	59	60	59	61	41
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 ¹	74	54	37	21	8	8	-20	8
A2. New public sector loans on less favorable terms in 2013-2033 ²	74	66	62	61	62	63	76	59
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	74	65	61	59	60	59	61	41
B2. Export value growth at historical average minus one standard deviation in 2014-2015 ³	74	96	134	132	132	129	129	65
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	74	65	61	59	60	59	61	41
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 ⁴	74	75	69	69	69	69	68	42
B5. Combination of B1-B4 using one-half standard deviation shocks	74	89	102	103	103	102	101	54
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 ⁵	74	65	61	59	60	59	61	41
PV of debt-to-revenue ratio								
Baseline	71	70	69	67	67	64	66	46
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 ¹	71	58	41	24	9	9	-21	9
A2. New public sector loans on less favorable terms in 2013-2033 ²	71	70	70	69	69	68	83	68
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	71	71	71	69	69	66	68	48
B2. Export value growth at historical average minus one standard deviation in 2014-2015 ³	71	86	111	109	107	102	96	50
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	71	79	88	86	85	82	85	59
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 ⁴	71	80	80	79	78	75	74	47
B5. Combination of B1-B4 using one-half standard deviation shocks	71	91	108	106	105	100	95	53
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 ⁵	71	98	97	95	94	90	93	65

Table 3b. Lesotho: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013–2033 (continued)

Debt service-to-exports+remittances ratio								
Baseline	3	3	2	2	2	2	4	5
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 ¹	3	2	1	1	2	1	3	-1
A2. New public sector loans on less favorable terms in 2013-2033 ²	3	2	2	2	3	2	7	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	3	2	2	2	3	2	8	2
B2. Export value growth at historical average minus one standard deviation in 2014-2015 ³	3	2	3	4	5	4	14	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	3	2	2	2	3	2	8	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 ⁴	3	2	2	2	3	3	9	3
B5. Combination of B1-B4 using one-half standard deviation shocks	3	2	2	3	4	4	12	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 ⁵	3	2	2	2	3	2	8	2
Debt service-to-revenue ratio								
Baseline	3	3	3	2	2	2	4	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 ¹	3	2	2	1	2	1	3	-1
A2. New public sector loans on less favorable terms in 2013-2033 ²	3	2	2	2	3	3	8	4
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	3	2	2	2	3	3	9	3
B2. Export value growth at historical average minus one standard deviation in 2014-2015 ³	3	2	2	3	4	3	10	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	3	2	3	3	4	3	11	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 ⁴	3	2	2	2	4	3	10	3
B5. Combination of B1-B4 using one-half standard deviation shocks	3	2	3	3	4	3	11	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 ⁵	3	3	3	3	5	4	13	4
<i>Memorandum item:</i>								
Grant element assumed on residual financing (i.e., financing required above baseline) ⁶	13	13	13	13	13	13	13	13

Sources: Lesotho authorities; and staff estimates and projections.

¹ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

² Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

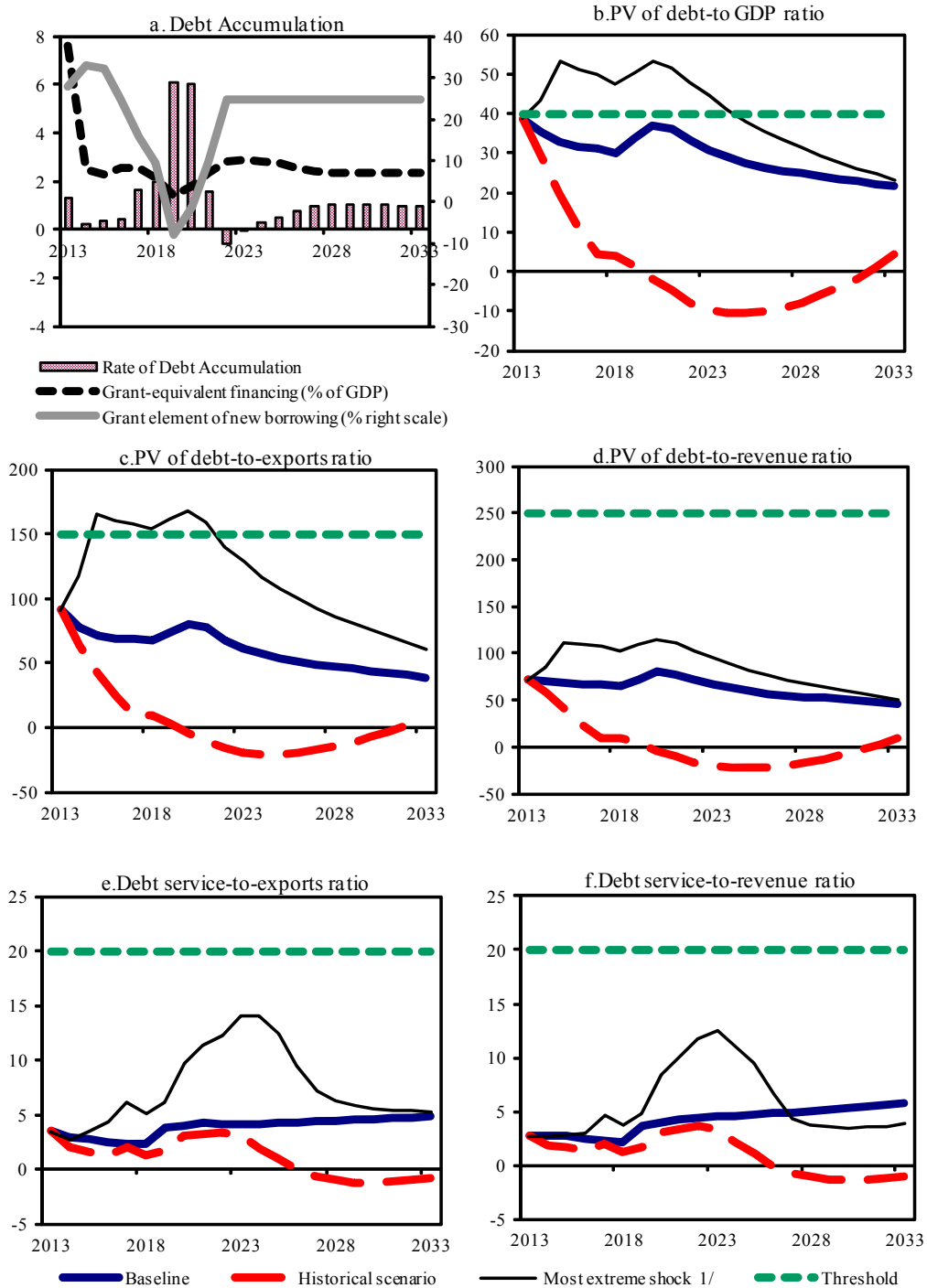
³ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

⁴ Includes official and private transfers and FDI.

⁵ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

⁶ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

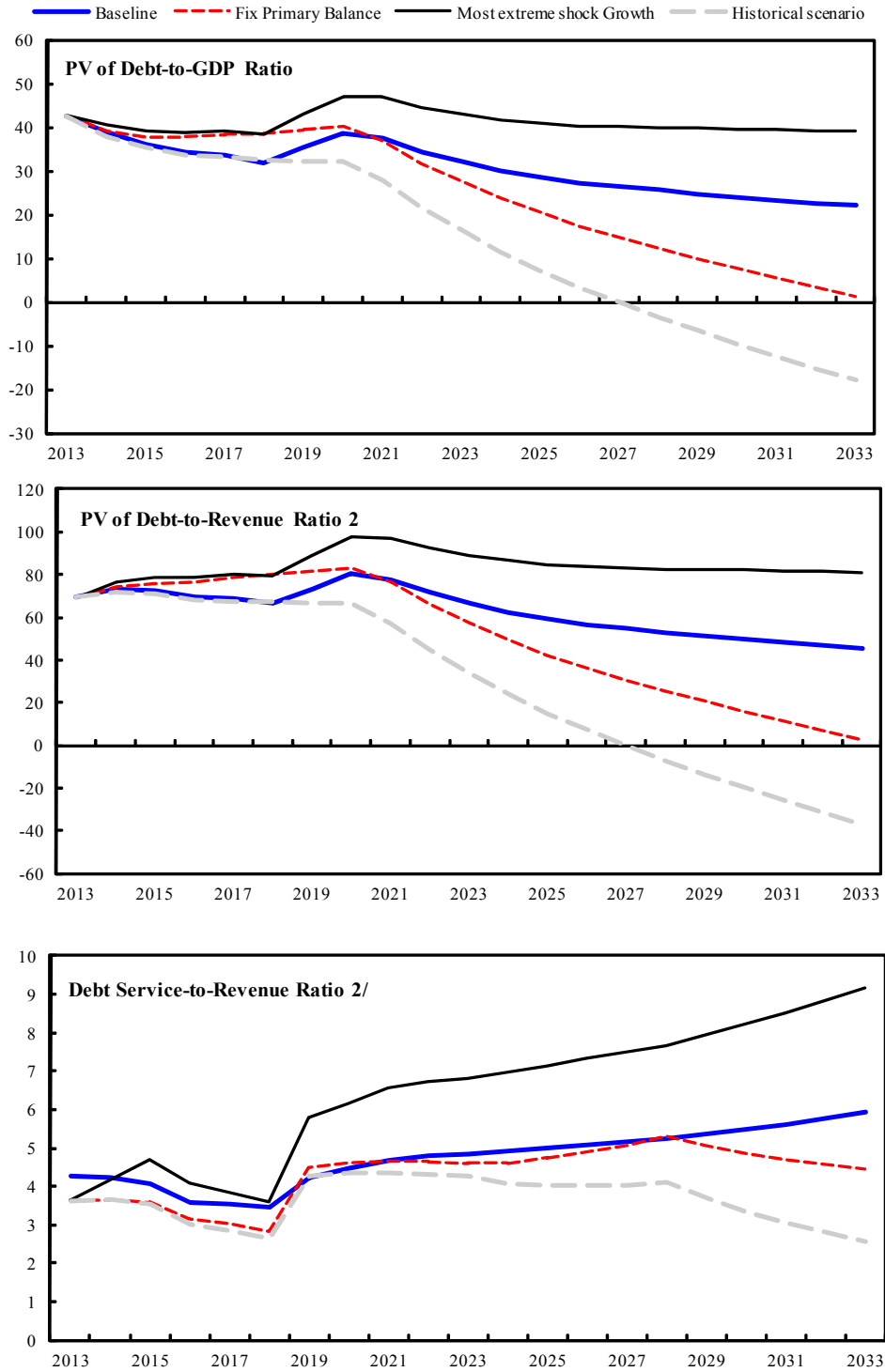
Figure 1a. Lesotho: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2013–2033¹



Sources: Lesotho authorities; and IMF staff estimates and projections.

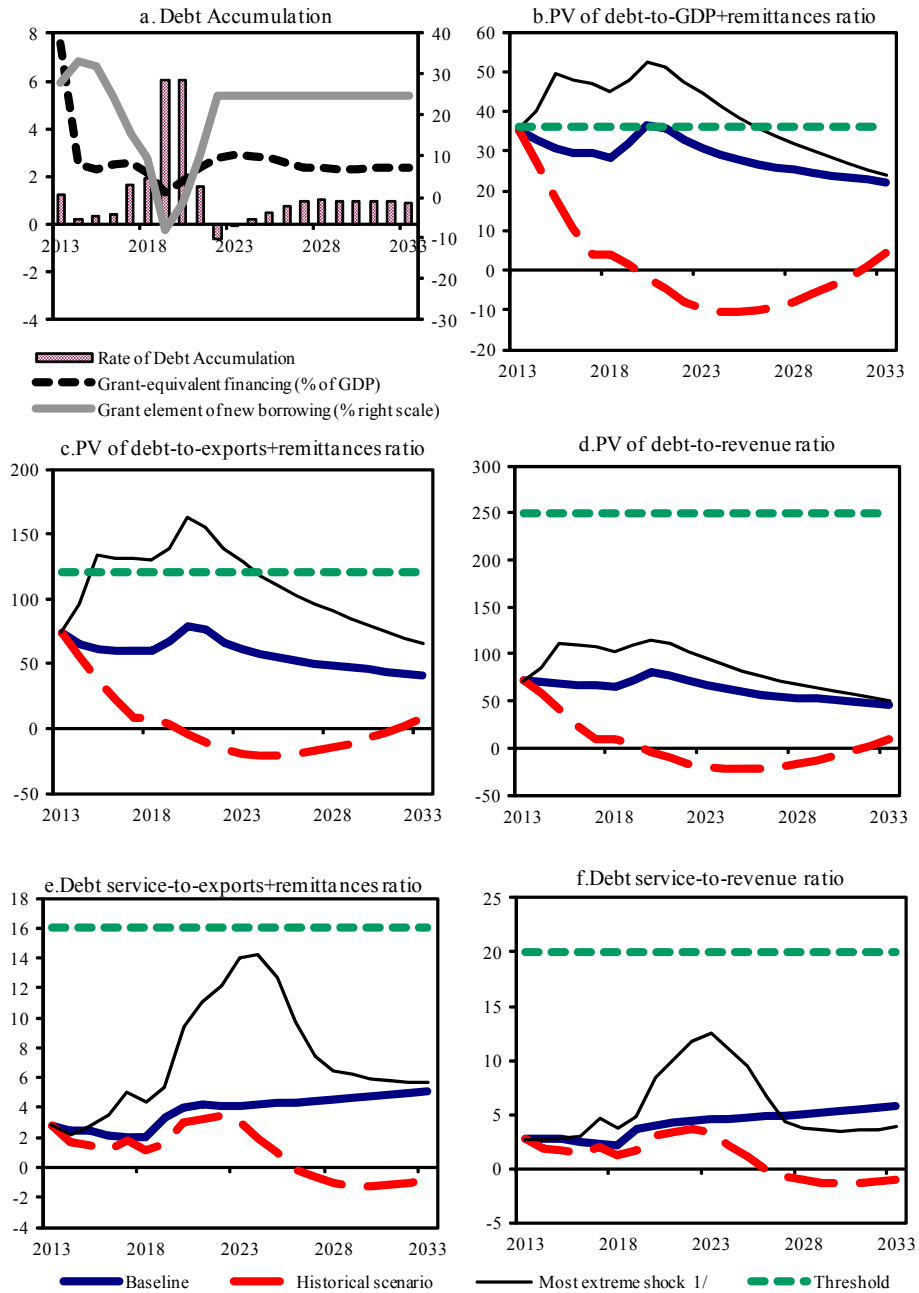
¹ The most extreme stress test is the test that yields the highest ratio in 2033. In figure b. it corresponds to a Exports shock; in c. to a Exports shock; in d. to a Exports shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 1b. Lesotho: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2013–2033¹



Sources: Lesotho authorities; and IMF staff estimates and projections.
¹ The most extreme stress test is the test that yields the highest ratio in 2023.
² Revenues are defined inclusive of grants.

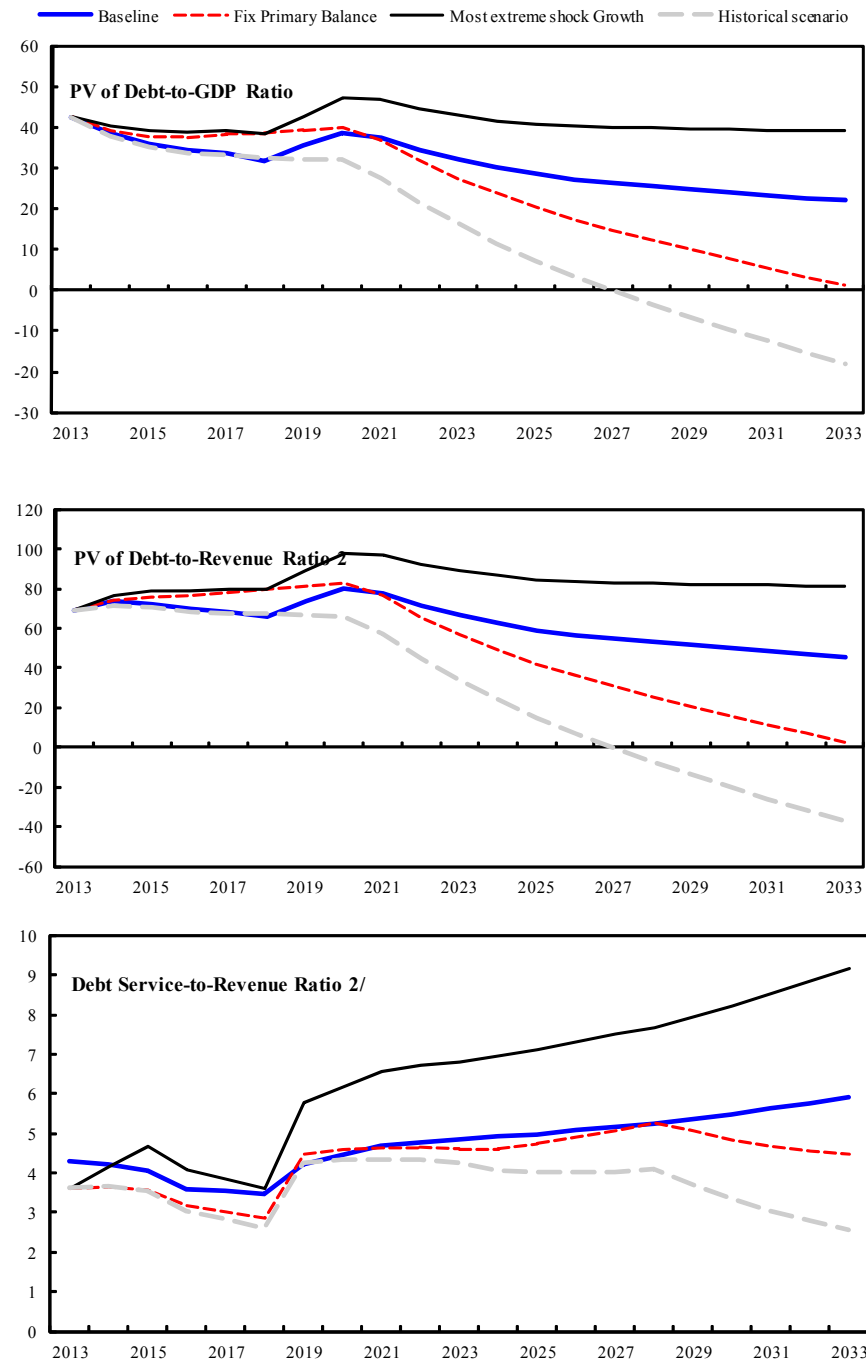
Figure 2a. Lesotho: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2013–2033¹



Sources: Lesotho authorities; and IMF staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2033. In figure b. it corresponds to a Exports shock; in c. to a Exports shock; in d. to a Exports shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 2b. Lesotho: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2013–2033¹



Sources: Lesotho authorities; and IMF staff estimates and projections.
¹ The most extreme stress test is the test that yields the highest ratio in 2033.
² Revenues are defined inclusive of grants.



Press Release No. 13/334
FOR IMMEDIATE RELEASE
September 9, 2013

International Monetary Fund
Washington, D.C. 20431 USA

IMF's Executive Board Completes the Sixth Review Under the ECF Arrangement for the Kingdom of Lesotho, and Approves US\$8.6 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) completed the sixth and final review of the Kingdom of Lesotho's performance under the program supported by the Extended Credit Facility (ECF) arrangement. Completion of the review will allow for the disbursement of an amount equivalent to SDR 5.68 million (about US\$8.6 million), bringing disbursements under the arrangement to an amount equivalent to SDR 50.605 million (about US\$76.6 million). The authorities have expressed interest in a successor arrangement, which would expedite achieving the medium-term reserve target, help address structural weaknesses, and catalyze support from its international partners.

The Kingdom of Lesotho's three-year ECF arrangement was approved on June 2, 2010 (See [Press Release No. 10/224](#)) with total access equivalent to SDR 41.88 million (about US\$63.4 million). To cushion the impact of the 2010–11 flood damage and high international commodity prices, the Executive Board approved an augmentation of access of 25 percent of quota in April 2012, bringing total access to SDR 50.605 million (about US\$76.6 million), under the ECF arrangement ([See Press Release No. 12/126](#)).

At the conclusion of the Executive Board's discussions, Mr. Naoyuki Shinohara, Deputy Managing Director and Acting Chair, made the following statement:

“Lesotho's macroeconomic policies, supported by the ECF arrangement, have served to ensure macroeconomic stability and secure robust growth. Despite a series of adverse shocks, including the fall in Southern African Customs Union (SACU) revenues in 2010–11 and weather-related shocks in 2011 and 2012, fiscal and external sustainability have been maintained. Economic growth has been robust for the last three years; inflation has subsided, reflecting moderation in international commodity prices.

“The authorities remain committed to prudent fiscal policies. With fiscal adjustment efforts and the recovery of SACU revenues, in 2012/13, a fiscal surplus was recorded for the first time since 2008/09. In light of the downside risks associated with the global and regional economic outlook, it will be important to maintain prudent fiscal policies by containing

recurrent spending and improving revenue administration. Such a policy stance will help Lesotho achieve reserve coverage of five months of imports, its medium-term target for international reserves.

“To support the implementation of prudent fiscal policies, further progress in public financial management and civil service reforms is needed. The establishment of the Cash Management Unit and the monthly reconciliation of all treasury accounts will help improve expenditure control and the monitoring of revenue collection.

“The authorities have made progress in improving the business climate and promoting private sector-led growth, with developing the national identification card system. The Central Bank of Lesotho continues to improve the regulatory frameworks for banks and nonbank financial institutions to promote financial sector developments with proper supervisory oversight.

“The authorities’ strong policy efforts, supported by the ECF arrangement, have helped attain macroeconomic stability and strong growth. Given the economic challenges that Lesotho still faces, continued engagement with the Fund should further support the authorities’ efforts, building on the progress under the current arrangement”, Mr. Shinohara stated.